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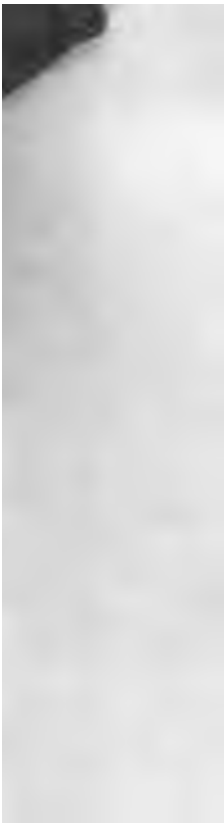
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**FINANCIAL INSTITUTIONS RESTRUCTURING AND
SERVICES ACT OF 1981**

HEARING
BEFORE THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 1686

TO AMEND THE FEDERAL RESERVE ACT TO PROVIDE THAT
DEPOSITS OF STATE AND LOCAL GOVERNMENTS WILL NOT
BE SUBJECT TO RESERVE REQUIREMENTS, AND FOR OTHER
PURPOSES

S. 1703

TO ENHANCE THE COMPETITIVENESS OF THRIFT INSTITU-
TIONS, TO PROTECT DEPOSITORS AND CREDITORS OF SUCH
INSTITUTIONS, AND FOR OTHER PURPOSES

S. 1720

TO ENHANCE THE COMPETITIVENESS OF DEPOSITORY INSTI-
TUTIONS, TO EXPAND THE RANGE OF SERVICES PROVIDED
BY SUCH INSTITUTIONS, TO PROTECT DEPOSITORS AND
CREDITORS OF SUCH INSTITUTIONS, AND FOR OTHER
PURPOSES

S. 1721

TO COMBINE THE INSURANCE FUNDS OF THE FEDERAL DE-
POSIT INSURANCE CORPORATION, THE FEDERAL SAVINGS
AND LOAN INSURANCE CORPORATION AND THE NATIONAL
CREDIT UNION SHARE INSURANCE FUND, AND FOR OTHER
PURPOSES

PART I

OCTOBER 19, 20, 21 AND 22, 1981

Printed for the use of the Committee on Banking,
Housing, and Urban Affairs

[97-37]



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U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1981

86-082 O

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FINANCIAL INSTITUTIONS RESTRUCTURING AND SERVICES ACT OF 1981

MONDAY, OCTOBER 19, 1981

**U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
*Washington, D.C.***

The committee met at 9:05 a.m. in room 5302 of the Dirksen Senate Office Building; Senator Jake Garn, chairman of the committee, presiding.

Present: Senators Garn, Chafee, Schmitt, Proxmire, Cranston, and Dixon.

OPENING STATEMENT OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order. This morning marks the opening of the committee consideration of legislation which I am confident will mark the beginning of a new era of growth and stability for the Nation's financial system.

Almost 50 years ago, Congress rejuvenated a financial system suffering from the ravages of the Depression. To protect depositors, the FDIC was established. To promote mortgage financing, the home loan bank system became a reality. To protect the integrity of financial institutions, the business of commercial banking was statutorily separated from other forms of commerce.

What has resulted from such actions is a highly regulated and compartmentalized system, which has served the capital and financial needs of our country for five decades. We are now faced with new challenges brought on by diverse causes, of which we are all well aware, for example, high interest rate and inflation, increased competition among depository and nondepository institutions, development of sophisticated communications and other technical equipment, and the internationalization of financial and economic markets.

What Congress must do now is to revamp the statutory framework established over the past 50 years to insure that the financial system is able to continue to meet the savings and credit needs of the Nation.

The layers of competitive restrictions and regulatory requirements on depository institutions have to be reduced if those institutions are to compete in a changing environment with innovative and aggressive nondepository financial intermediaries. The legislation before the committee today, S. 1703, the administration-Pratt bill; S. 1720, the financial restructuring bill; S. 1721, the insuring agencies consolidation bill; and S. 1686, the local government NOW account bill, represents the first step toward comprehensive restructuring and upgrading of the financial system.

As I have noted in statements introducing S. 1720, and announcing these hearings, S. 1720 represents the efforts of several committee and former committee members. Senators Heinz, Lugar, Chafee, D'Amato, Tsongas, and Mitchell are responsible for introducing in separate bills parts of S. 1720. Senator Proxmire, the distinguished former chairman of the Banking Committee, is a cosponsor of many of the individual bills. Thus I express my thanks to them and look forward to their continued interest in enacting necessary revisions to the banking statutes.

Pending legislation before the committee will sharpen the focus of the members, resulting in what should be final congressional action this year on a bill that will address some of the fundamental issues facing our financial system. Final legislation may not include all of that which is before the committee now, but I am confident that it will contain most of the major components.

For the past several years, this committee has considered various issues affecting the health and condition of financial institutions. What this legislation and these hearings represent are remedies for the health problems that go far beyond temporary relief.

There can be little doubt that financial market conditions have changed dramatically during the past 10 years. Consumers are interested more than ever in obtaining the market rate on their savings, putting an end to the historical pattern of low-yielding deposits, subsidizing relatively low-cost loans. Corporations, eager to keep their credit costs down, have issued large amounts of commercial paper, thereby bypassing banks as middlemen in the credit process. New financial products and services, such as money market funds and the secondary market for commercial paper have sprung up to serve the needs of the individual and business consumers. Such new developments, often the work of nondepository institutions, have heightened competition within the financial services industry.

By removing the unnecessary competitive restrictions and reducing traditional Government involvement in the operations of depository institutions, the legislation before the committee would allow such institutions the necessary latitude to determine for themselves how best to serve the savings and credit needs of their customers. Congress has considered revisions to existing competitive restrictions on depository institutions for several years. It began the process last year with the Depository Institutions Deregulation Act.

The pending legislation representing ideas and issues that have been before this committee as long, or longer, than I have been a Member of the Senate, represents another step toward a competitive and a stronger financial system.

Let me remind everyone that in preparation for this particular legislation we did hold 7 days of very intensive and detailed hearings this past spring. Those hearings were published in the last couple of weeks, more than 2,000 pages of testimony and information on which to base the direction that we now are going.

To sum up what I have said, it is just simply in my opinion that we have reached a point where we have a revolution going on in the financial services industry. The nondepository institutions that you are all well aware of—the Secretary's former company, Mer-

rill, Lynch; American Express buying Shearson; Prudential buying Bache; Sears' getting involved in all of their new types of financial activities outside of the banking laws—we have created a very unfair situation. An unbalanced playing field, with some financial organizations not being able to have to abide by the same rules and regulations as other.

As I said in the hearings last spring, there are two ways you can go. There was a great clamor at that time for imposing reserve requirements on the money market funds and the nondepository type institutions. I reject that idea. It is against my basic philosophy to put more and more Government regulations on business. So the other alternative is to reduce the present rules and regulations on the depository institutions so that Government is not creating an unfair competitive situation. This is the beginning of that effort to restructure and reduce those rules and regulations that have hampered competition, so that the new types of institutions will not have an unfair competitive advantage.

So we are pleased to start these hearings today. And I would first turn to Senator Chafee to see if he has any opening remarks, before we go to the Secretary.

OPENING STATEMENT OF SENATOR CHAFEE

Senator CHAFEE. Well, thank you very much, Mr. Chairman. And I, too, want to welcome Secretary Regan to these hearings. And I also want to commend you, Mr. Chairman, for calling the hearings so swiftly following the introduction of the administration's proposals. The kind of structural changes proposed by the administration and included in title I of S. 1720, I don't believe can be viewed in a vacuum. They affect more than just the industry they are intended to aid. They affect the role of the S. & L.'s relative to the commercial banking, and the financial community in general—relationships which have been established by banking law that, as you know, has existed for decades.

Thus, the remedies for the thrifts, even narrowly drawn, will have a pervasive effect on other financial institutions. Moreover, the problems themselves that have led to the financial difficulties of the thrifts are also experienced by the commercial banking industry. Obviously, the thrifts have been hardest hit by economic conditions and problems in the housing industry. But economic conditions have contributed to increased competition by nondepository institutions, as you mentioned, and this competition has hurt banks along with savings and loan associations.

I agree with the broad approach we are taking, because many of the problems are widely shared and even the narrowest solutions will be widely felt. S. 1720 and S. 1721 will make some very important, valuable reforms that I believe will aid the thrift industry, promote competition, and encourage a broader range of services available to the consumer.

And I am delighted that the proposals I have advanced will allow banks, thrifts, and credit unions to offer commingled account services, including money market mutual funds. I am glad that has been included.

I completely agree with you, rather than imposing the restrictions on those institutions that are currently offering the money

market funds, it is better to free up those who are currently not able to compete because of the restrictions imposed upon them. I think such a measure as the commingling would help the banks and the thrifts by stemming customer outflow. Those institutions that set up their own funds would benefit from the fees generated. The proposal would also benefit the small investor by making available from depository institutions investment services that were previously available only to the wealthy.

We look forward to the distinguished witnesses that will be testifying and submitting their statement over the next few weeks to help us in shaping this legislation. So, Mr. Chairman, I look forward to these hearings. And I am glad the Secretary is here.

The CHAIRMAN. Thank you, Senator Chafee.

Mr. Secretary, we would be happy to hear your testimony at this time.

STATEMENT OF DONALD T. REGAN, SECRETARY, DEPARTMENT OF THE TREASURY

Secretary REGAN. Thank you, Mr. Chairman and members of this distinguished committee. I appreciate the opportunity to present to this committee some recommendations developed by the administration to improve the operations of our financial system.

IMPROVING OUR FINANCIAL SYSTEM

I would like to discuss our recommendations in conjunction with your proposals, Mr. Chairman, and with those of other members of this committee, as contained in S. 1720, the Financial Institutions Restructuring and Services Act of 1981. I am delighted to see in the legislation developed by this committee so many ideas for improving our financial system that are shared by those of us in the administration.

As we proceed with our work, we must keep in mind the basic objective of providing the public with the best possible financial system. In recent years, the present system has produced an exceptional number of new products and services, many of them conveniences and benefits for consumers which cannot be offered by traditional depository institutions. Our financial system has evolved with a long history of institutional, product, and geographic restrictions generally for anticompetitive reasons, but in some cases to protect depository institutions themselves against risky ventures which might jeopardize their soundness and require the expenditure of Federal Deposit Insurance Funds.

In order to receive better products and services, or just a better return on their savings, consumers have frequently had to shift their funds from one institution to another, and in many cases outside the banking system itself. To avoid such distortions in the financial system, and the accompanying institutional and consumer inconveniences, we must rely more on deregulated markets and institutions.

With fewer Government restrictions, the financial system should respond more efficiently to changes in the economic and competitive environments for the benefit of everyone. This deregulatory effort is important to the administration, not only because it com-

ports so well with the President's regulatory reform program, but because the effort should be especially beneficial to consumers.

Those sections of S. 1720 dealing with the expanded powers of thrift institutions, savings and loan associations, and mutual savings banks, are justifiably an important priority of this committee. The thrift industry has always had problems in high interest rate periods, and it will continue to have them in future years, if fundamental changes are not made in the way it does business.

Providing thrift institutions with new asset powers need not diminish their contribution to housing finance. Real estate lending is their area of greatest expertise, and they are likely to continue expanding this activity. The ability to make shorter term commercial and consumer loans should supplement their real estate lending and help the industry stabilize its earnings in periods when there is demand for commercial and consumer loans, but very little demand for mortgages. At the same time, more stable deposits, which will occur when thrift institutions are able to pay competitive rates on their deposits, should help ameliorate the cyclical character of the flow of credit to housing.

Moreover, we expect the new alternative mortgage instruments to make real estate lending more attractive to many financial institutions. S. 1720 would give thrift institutions many of the same asset and liability powers that commercial banks now have. We recognize that this legislation would not eliminate all inequalities between thrift institutions and commercial banks. But it would move us a long way in that direction.

Remaining inequalities can be dealt with at a later date, in other legislation, and in that regard we will shortly propose legislation that will address the tax disadvantages that result for commercial banks whose portfolios are configured like those of thrift institutions.

PROVISIONS IN S. 1720

These generally small banks, primarily engaged in housing finance, will be offered the same tax treatment as thrift institutions, which should significantly enhance the equal treatment of all types of small depository institutions. In this regard, Mr. Chairman, I would like to note that S. 1720 contains a number of provisions, which my written statement discusses in more detail, that would ease the burden of certain statutory constraints on small depository institutions.

The administration is especially pleased that steps are being taken to enhance the competitive potential of these institutions. Many other strictures on commercial banks, both small and large, should be alleviated. But until they are, thrift institutions should not be given advantages over commercial banks.

For example, S. 1720 would prohibit interstate branching by federally chartered thrift institutions that take on bank powers as defined in the legislation. We endorse this approach, because we believe it is essential to put thrift institutions doing bank-like business on the same geographic footing as commercial banks, until the ground rules for interstate branching of all kinds of depository institutions can be revised.

However, S. 1720 does not restrict intrastate branching by federally chartered thrift institutions that exercise bank-like powers. It would be desirable if the State governments equalized the branching powers of all depository institutions under their jurisdiction, and did so by liberalizing those powers to permit unrestricted intrastate branch banking. This would strengthen the State banking systems prior to any expansion of the interstate activities of depository institutions. In that connection, as soon as this committee is prepared, Mr. Chairman, I would like to present administration proposals to liberalize those interstate activities.

This legislation contains very important provisions authorizing emergency interstate and interindustry mergers and acquisitions to rescue troubled commercial banks and thrift institutions. These provisions would greatly assist the regulatory agencies in coping with problem organizations. We therefore regard the provisions for interindustry and interstate mergers and acquisitions as an essential element of any legislative assistance to the thrift industry.

S. 1720 would provide broader language regarding the ability of the Federal Deposit Insurance Corporation to provide assistance to an insured institution. In the past we have generally opposed such a broadening of financial assistance language for the Federal deposit insurance agencies, because we believe they already have the substance of the authority that the language provides. And most importantly, we do not want them to consider congressional action as a mandate for accelerated spending on assistance to an industry frozen in a noncompetitive framework. We believe it would be a significant disservice to the public if Congress were to provide some form of short-term assistance to thrift institutions while leaving action on their fundamental problems to a later date or another Congress.

However, in the context of this proposed legislation, which addresses the thrift industry's long-term structural difficulties, we would not object to the new language regarding the conditions under which the FDIC may assist a troubled institution.

The Administration has reviewed the issue of preempting the due-on-sale clause prohibitions, and has determined that a preemption is necessary and appropriate. We would confine the preemption to federally chartered depository institutions as well as lenders other than State-chartered depository institutions approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act. The difficulties of the thrift industry and the Federal Government's stake in the viability of the industry through the Federal deposit insurance agencies make preemption a legitimate Federal concern, and one that requires prompt action.

REVISE GLASS-STEAGALL

I would like to now turn to those sections of S. 1720 that deal with the Glass-Steagall Act. As you know from my testimony before this committee in April, I feel strongly about the need to revise this nearly 50-year-old statute. Mr. Chairman, we have developed an approach to deregulation of securities activities that differs from the approach contained in 1720.

We propose that commercial banks be authorized to engage in municipal revenue bond underwriting and dealing and the sponsoring and underwriting of mutual funds, provided that they do so through a bank holding company subsidiary. The subsidiary would function as a full member of the securities industry. It would be eligible for membership in the appropriate securities industry self-regulatory organizations, such as the National Association of Securities Dealers, and would be regulated at the Federal Government level, by the Securities and Exchange Commission.

Any bank electing to create a subsidiary would have to transfer to it all other traditional securities business, such as underwriting and dealing in U.S. Treasury and municipal general obligation bonds.

Parenthetically, Mr. Chairman, I might mention that with regard to competitive equality, a securities firm dealing only in Federal, municipal, or mutual fund obligations could establish a holding company and own a commercial bank within it.

Our approach to deregulation of securities activities has three major advantages: (1) It establishes an equal competitive footing for securities firms and commercial banks with respect to their common securities activities; (2) it establishes the holding company vehicle as a means to expand the activities of bank holding companies generally and securities subsidiaries in particular; (3) It uses the holding company vehicle to separate the federally insured depository business of banking from activities that may have a higher degree of risk. Our proposed bank holding company security subsidiary would have the same tax treatment as an independent securities firm, the same regulators, and the same access to outside financing and outside customers.

In contrast, leaving securities activities submerged within the corporate structure of a commercial bank, as S. 1720 presently does, would afford the banks several competitive advantages in the securities business. The bank securities activities would have preferential tax treatment, particularly as regards the carrying of securities in inventory. They would be regulated by the Federal bank regulatory agencies for which securities activities are only a limited aspect of bank business. They would have access to financing based upon the cost of the bank's insured deposits, and they would have opportunities for the non-arm's-length linkage of traditional bank services to the securities business of the bank.

There are too many inequalities here to satisfy the goal of equal treatment for all financial institutions doing the same kinds of business. We are prepared to submit legislation to implement our securities subsidiary concept, Mr. Chairman. In addition, we are prepared to make a study within 2 years after the effective date of the law regarding the impact of these new bank securities activities and to determine what additional activities might be appropriate.

Recent events have brought into sharp focus the fact that the financial services market is growing rapidly, and that many companies are broadening the range of services they offer to businesses and the consumer. Increasingly, this is a direct challenge to banks and bank holding companies whose range of possible financial services is restricted by regulation.

I believe that the time has come to permit bank holding companies to compete more fully with the many firms which are now entering the financial services market. Insofar as the greater risk of new activities can be separated from the risks of traditional banking business, we would support additional activities for bank and thrift holding companies beyond those now permitted. For example, Mr. Chairman, the thrift industry would like to make direct investments in real estate, as distinguished from mortgage loans, to make use of their expertise and experience in local real estate. This, of course, would create a quantum of additional and different risks for these insured institutions.

I would have no objection if federally chartered thrift institutions were given this authority, provided that all direct investments in real estate were made through a holding company subsidiary; and that commercial banks, through a holding company subsidiary, were given the same authority.

Mr. Chairman, in closing, let me note that my written testimony includes a more detailed administration position on S. 1720, and some comments on S. 1721.

I would like to thank the committee again for offering me this opportunity to present the Treasury Department's and the administration's views on issues relating to the financial system, issues about which I feel very strongly. I would also like to thank you, Mr. Chairman, for all of the work you have done in arranging these hearings, and in preparing this legislation. We in the administration would like to work closely with the Congress to secure passage of the legislation.

Mr. Chairman, that concludes my statement. And I would be pleased to answer any questions that the committee might have.

[Complete statement follows:]

FOR RELEASE UPON DELIVERY

Expected at 9:00 a.m.

October 19, 1981

Testimony of the Honorable Donald T. Regan
Secretary of the Treasury
Before the
Senate Committee on Banking, Housing and Urban Affairs

Mr. Chairman and members of this distinguished Committee:

I appreciate the opportunity to present to you some recommendations developed by the Administration to improve the operations of our financial system. The recommendations follow from the hearings held by the Committee in April to review the impact of recent legislation on our financial markets and financial institutions. At that time I indicated I would return to the Committee with specific proposals to implement the deregulation policies I outlined at those hearings.

I would like to discuss our recommendations in conjunction with your proposals, Mr. Chairman, and with those of other members of this Committee as contained in S. 1720, the Financial Institutions Restructuring and Services Act of 1981, and S. 1721, a bill to combine the insurance funds of the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation and the National Credit Union Share Insurance Fund. I am delighted to see in the legislation developed by this Committee so many ideas for improving our financial system that are shared by those of us in the Administration.

INTRODUCTION

As we proceed with our work we must keep in mind the basic objective of providing the public with the best possible financial system. In recent years, the present system has produced an exceptional number of new products and services, many of them conveniences and benefits for consumers which cannot be offered by commercial banks. Our financial system has evolved with a long history of institutional, product and geographic restrictions, generally for anticompetitive reasons, but in some cases to protect depository institutions themselves against risky ventures which might jeopardize their soundness and require the expenditure of Federal deposit insurance funds. In order to receive better products and services or just a better return on their savings, consumers have frequently had to shift their funds from one institution to another, from local to metropolitan markets, and in many cases outside the banking system itself.

This redistribution of funds solely to avoid governmental constraints has tended to weaken traditional depository institutions, the most restricted segment of the financial system. It has also tended to disadvantage the rural communities and housing segment of the economy dependent on these institutions. To avoid such distortions in the financial system and the accompanying institutional and consumer inconveniences, we must rely more on deregulated markets and institutions. With fewer governmental restrictions, the financial system should respond more efficiently to changes in the economic and competitive environments to the benefit of everyone. This deregulatory effort is important to the Administration not only because it comports so well with the President's regulatory reform program but because the effort should be especially beneficial to consumers.

EXPANDED POWERS FOR THRIFT INSTITUTIONS

Those sections of S. 1720 dealing with expanded powers for thrift institutions--savings and loan associations and mutual savings banks--are justifiably an important priority of this Committee. At the moment the distortions and uncertainty caused by inflation, in interaction with continuing asset regulation, are forcing thrift institutions to use an increasing amount of deposit liabilities with interest rates that vary with market rates to make long-term mortgage loans or to carry long-term mortgages made in prior years. The remainder of the institutions' deposits are under Federal deposit interest rate ceilings and have rates that vary with market rates only below the ceilings.

However, most thrift institution mortgages have fixed interest rates set when the loans were made, often years ago, at rates substantially below current market levels. The ratio of variable rate mortgages to total thrift industry loans is much smaller than the proportion of rate sensitive deposits relative to total deposits.

This imbalance between increasingly rate sensitive liabilities and long-term relatively rate insensitive assets is central to the thrift industry's current problems.

The thrift industry has always had problems in high interest rate periods and it will continue to have them in future years if fundamental changes are not made in the way it does business. The severity of the industry's difficulties in 1981 should have convinced everyone that the governmental restrictions on its business need to be removed, so that the industry can structure its assets and liabilities to be as viable as other depository institutions in any interest rate environment. If we do not lift these restrictions now, we will only have to do so at some later time at a greater cost to thrift institutions and consumers.

Providing thrift institutions with new asset powers need not diminish their contribution to housing finance. Real estate lending is their area of greatest expertise and they are likely to continue expanding this activity. The ability to make shorter-term commercial and consumer loans should supplement their real estate lending and help the industry stabilize its earnings in periods when there is a demand for commercial and consumer loans but very little demand for mortgages. At the same time, more stable deposits--which will result when thrift institutions are able to pay competitive rates on their deposits--should help ameliorate the cyclical character of the flow of credit to housing. Moreover, we expect the new alternative mortgage instruments to make real estate lending more attractive to many financial institutions.

S. 1720 would give thrift institutions many of the same asset and liability powers that commercial banks now have. We believe this is appropriate since our goal is to permit all depository institutions eventually to compete on equal terms. We recognize that this legislation would not eliminate all inequalities between thrift institutions and commercial banks but it would move us a long way in that direction, and it is important that we make as much progress as possible deregulating thrift institutions at this time. Remaining inequalities can be dealt with at a later date in other legislation, and in that regard, we will shortly propose legislation that will address the tax disadvantages that

result for commercial banks whose portfolios are configured like those of thrift institutions. These generally small banks primarily engaged in housing finance will be offered the same tax treatment as thrift institutions, which should significantly enhance the equal treatment of all types of small depository institutions.

In this regard and at this time, Mr. Chairman, I would like to mention that the Administration favors the simplification or other easing of the truth-in-lending and community reinvestment statutes and the provisions relating to officers and directors in the Financial Institutions Regulatory and Interest Rate Control Act of 1978. Small institutions need relief from these burdensome restrictions on their business. The Administration is especially pleased that steps are being taken to enhance the competitive potential of these institutions.

Many other strictures on commercial banks, both small and large, should be alleviated, but, until they are, thrift institutions should not be given advantages over commercial banks. For example, S. 1720 would prohibit interstate branching by Federally chartered thrift institutions that take on bank powers as defined in the legislation. There are currently no statutory restrictions on the interstate branching of savings and loan associations and this provision would introduce such a restriction for associations exercising bank powers. We endorse this approach because we believe it is essential to put thrift institutions doing bank-like business on the same geographic footing as commercial banks, until the ground rules for interstate branching by all kinds of depository institutions can be revised.

However, S. 1720 does not restrict intrastate branching by Federally chartered thrift institutions that exercise bank powers. There are several states where an inequality already exists between the branching practices of thrift institutions and commercial banks. It is appropriate that S. 1720 retains these differences by not restricting the branching of thrift institutions exercising their new powers, because we hope that any inequality in the intrastate branching authority of commercial banks and bank-like thrift institutions will be temporary.

It would be desirable if the state governments equalized the branching powers of all depository institutions under their jurisdiction and did so by liberalizing those powers to permit unrestricted intrastate branching. This would strengthen the state banking systems prior to any expansion of the interstate activities of depository institutions. In that connection, as soon as this Committee is prepared, Mr. Chairman, I would like

to present Administration proposals to liberalize those interstate activities. We have some proposals being discussed within the Administration that should be fully developed in a couple of months; however, we believe they should be dealt with in separate legislation that will not impede the progress of this bill.

INTERSTATE AND INTERINDUSTRY MERGERS

This legislation contains very important provisions authorizing emergency interstate and interindustry mergers and acquisitions to rescue troubled commercial banks and thrift institutions. These provisions would greatly assist the regulatory agencies in coping with problem organizations. They should also reduce the cost to the Federal deposit insurance agencies of assisting troubled institutions by opening attractive markets to acquirors who might pay a premium for a troubled institution in order to enter one of those markets. Allowing interstate and interindustry mergers would open the bidding for troubled institutions to more participants. This would promote a free market form of assistance to such organizations so all possible forms of private help could be exhausted before government assistance is extended. We therefore regard the provisions for interindustry and interstate mergers and acquisitions as an essential element of any legislative assistance to the thrift industry.

SHORT-TERM FINANCIAL ASSISTANCE MEASURES

S. 1720 contains several provisions which we favor that would strengthen the Federal deposit insurance agencies. It would authorize the Federal Savings and Loan Insurance Corporation (FSLIC) to borrow from the Federal Home Loan Bank Board (FHLBB), and the National Credit Union Share Insurance Fund to borrow from the Central Liquidity Facility for credit unions. This would provide both funds with indirect access to additional market resources. The bill would also increase the flexibility of the FSLIC in controlling refunds of its secondary reserve. It is hard to believe that the secondary reserve was reduced earlier this year at the same time that the FSLIC was seeking an increase in its Treasury line of credit.

S. 1720 would also provide broader language regarding the ability of the Federal Deposit Insurance Corporation (FDIC) to provide assistance to an insured institution. In the past we have generally opposed such a broadening of financial assistance language for the Federal deposit insurance agencies because we believe they already have the substance

of the authority the language provides; and, most importantly, we do not want them to consider Congressional action as a mandate for accelerated spending on assistance to an industry frozen in a noncompetitive framework. We believe it would be a significant disservice to the public if Congress were to provide some form of short-term assistance to thrift institutions while leaving action on their fundamental problems to a later date or another Congress. However, in the context of this proposed legislation, which addresses the thrift industry's long-term structural difficulties, we would not object to the new language regarding the conditions under which the FDIC may assist a troubled institution.

PREEMPTION OF DUE-ON-SALE CLAUSE PROHIBITIONS

The Administration has reviewed the issue of preempting due-on-sale clause prohibitions and has determined that a preemption is necessary and appropriate. We would confine the preemption to Federally chartered depository institutions, as well as lenders other than state chartered depository institutions -- approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act. State-chartered depository institutions have the ability to convert to a Federal charter if state due-on-sale prohibitions prove onerous or if the states do not eliminate such prohibitions, while state chartered nondepository institutions do not have the option to convert to a Federal charter. We would not, however, include in the Federal preemption a provision allowing the states to override this action by voting on whether to adopt or renew a due-on-sale prohibition within a specified period of time.

The difficulties of the thrift industry and the Federal government's stake in the viability of the industry through the Federal deposit insurance agencies make preemption a legitimate Federal concern and one that requires prompt action.

GLASS-STEAGALL ACTIVITIES

I would like now to turn to those sections of S. 1720 that deal with the Glass-Steagall Act. As you know from my testimony before this Committee in April, I feel strongly about the need to revise this nearly 50 year old statute. The legislation proposed would authorize commercial banks to underwrite and deal in municipal revenue bonds and would authorize all depository institutions to sponsor and underwrite shares of open-end investment companies (mutual funds). We propose

that only commercial banks be authorized to perform both these activities as an appropriate starting point in the liberalization of access to securities business by depository institutions. Ultimately we would favor all such institutions having the power to underwrite and deal in municipal revenue bonds and to sponsor mutual funds and underwrite their shares, but thrift institutions and credit unions will have enough new powers to develop for the time being.

Mr. Chairman, we have developed an approach to deregulation of securities activities that differs from the approach contained in S. 1720. We propose that commercial banks be authorized to engage in municipal revenue bond underwriting and dealing and the sponsoring and underwriting of mutual funds, provided they do so through a bank holding company subsidiary.

The subsidiary would function as a full member of the securities industry; it would be eligible for membership in the appropriate securities industry self regulatory organizations, such as the National Association of Securities Dealers, and would be regulated at the Federal government level by the Securities and Exchange Commission. Any bank electing to create a subsidiary would have to transfer to it all other traditional securities business, such as underwriting and dealing in U.S. Treasury and municipal general obligation bonds. Parenthetically, Mr. Chairman, I might mention that, with regard to competitive equality, a securities firm dealing only in Federal, municipal, or mutual fund obligations could establish a holding company and own a commercial bank within it.

Our approach to deregulation of securities activities has three major advantages.

1. It establishes an equal competitive footing for securities firms and commercial banks with respect to their common securities activities.
2. It establishes the holding company vehicle as a means to expand the activities of bank holding companies generally and securities subsidiaries in particular. I will have more to say on this subject later in my testimony today.
3. It uses the holding company vehicle to separate the Federally insured depository business of banking from activities that may have a higher degree of risk.

Our proposed bank holding company securities subsidiary would have the same tax treatment as an independent securities firm, the same regulators and the same access to outside financing and outside customers. In contrast, leaving securities activities submerged within the corporate structure of a commercial bank as S 1720 presently does would afford the bank several advantages in the securities business. The bank's securities activities would have preferential tax treatment particularly as regards the carrying of securities in inventory; they would be regulated by the Federal bank regulatory agencies for which securities activities are only a limited aspect of bank business; they would have access to financing based on the cost of the bank's insured deposits; and they would have opportunities for the non-arms length linkage of traditional bank services to the securities business of the bank. There are too many inequalities here to satisfy the goal of equal treatment for all financial institutions doing the same kinds of business.

We are prepared to submit legislation to implement our securities subsidiary concept Mr. Chairman. In addition, we are prepared to make a study, within two years after the effective date of the law, regarding the impact of these new bank securities activities and to determine what additional activities might be appropriate.

BANK HOLDING COMPANIES

Recent events have brought into sharp focus the fact that the financial services market is growing rapidly and that many companies are broadening the range of services they offer to business and the consumer. Increasingly, this is a direct challenge to banks and bank holding companies whose range of possible financial services is restricted by regulation. I believe that the time has come to permit bank holding companies to compete more fully with the many firms which are now entering the financial services market.

One important advantage of offering new financial services through a bank holding company rather than a bank is its ability to separate new functions from the traditional business of banking. This can be important if the new functions have or are perceived to have a greater element of risk. We must recognize Mr. Chairman, that banks are different from other institutions in that a substantial portion of the funds they receive are deposits insured by a Federal government agency. This gives banks an inherently lower cost of funds and also requires us to be circumspect in permitting banks to take risks which go beyond traditional banking practice. It is not appropriate for depository institutions to be taking on business with substantially

increased risks while enjoying insurance by the Federal government designed for institutions taking much less risk. If new functions are set apart from the bank itself in a holding company subsidiary the bank is insulated from these risks but may still carry on its customary business of accepting deposits and making loans.

Insofar as the greater risks of new activities can be separated from the risks of traditional banking business, we would support additional activities for bank and thrift holding companies beyond those now permitted. For example, Mr Chairman the thrift industry would like to make direct investments in real estate as distinguished from mortgage loans, to make use of its expertise and experience in local real estate. This, of course would create a quantum of additional and different risks for these insured institutions. We would have no objection if Federally chartered thrift institutions were given this authority, provided that all direct investments in real estate were made through a holding company subsidiary and that commercial banks, through a holding company subsidiary were given the same authority. In this way, the entity of which the thrift institution or bank is a part could increase its earnings and improve its financial condition, without endangering the safety of the thrift institution or bank or increasing the risks to the Federal deposit insurance fund and uninsured depositors.

This is but one example of a service which could be offered by a holding company--in direct competition with other kinds of enterprises--without subjecting the insured institution which is its subsidiary to risk. In a very real sense this approach will create the "level playing field" on which all institutions that offer financial services can compete while recognizing the uniqueness of depository institutions in our current financial system.

OTHER MATTERS

Now, Mr. Chairman, I would like to comment briefly on S. 1721 and on some other sections of S. 1720.

S. 1721 -- To Combine the Federal Deposit Insurance Funds

The idea of consolidating the three Federal deposit insurance agencies expressed in S. 1721 has considerable merit, although it seems premature until we have made some progress expanding the powers of thrift institutions. We would like to work with the Congress in exploring this proposal at a later date. As the powers of all depository institutions

become similar or the same, it seems inappropriate to have three separate insurance agencies. The objectives and financial activities of the three should be the same.

Depository Insurance of Retirement Accounts

We strongly oppose any increase in Federal deposit insurance including the increase from \$100,000 to \$250,000 for retirement accounts contained in S. 1720. Deposit insurance coverage for all accounts was raised from \$40,000 to \$100,000 only last year. That increase extended insurance coverage to all retail deposits (generally defined as those under \$100,000). A further increase at this time would, in effect, extend coverage to depositors who should be able to make investment decisions without reliance on deposit insurance and who should, by their actions, influence risk-taking by depository institutions. The discipline uninsured depositors bring to the business of commercial banks and thrift institutions is important.

Preemption of State Usury Ceilings

The Depository Institutions Deregulation and Monetary Control Act of 1980 preempts state usury ceilings on mortgage and commercial loans, if state legislatures do not reinstate the ceilings for their states within three years from the effective date of the Act. We favor preemption of usury ceilings for all loans in the manner prescribed in the Deregulation Act, as proposed in S. 1720. In our opinion, usury ceilings only distort financial markets and credit flows and do not reduce the cost of credit in the economy.

Banking Affiliates

We support the proposed revisions of Section 23A of the Federal Reserve Act so long as they are not expanded to give member organizations of a bank holding company more favorable treatment than organizations outside the holding company. This is a significant issue given our proposed reliance on bank holding companies for arms-length treatment of securities and other subsidiaries.

Exemption from Reserve Requirements

We favor exempting depository institutions with less than \$5,000 000 in deposits from reserve requirements, if the dollar amount of deposits necessary to qualify for the exemption is increased by 100% of the percentage increase in

total depository institution deposits, rather than by 80% as contained in the proposed legislation. This change should lift an unnecessary burden from small institutions.

International Banking Facilities

The Administration favors the establishment of domestic international banking facilities free from FDIC deposit insurance and assessment; however, we believe the debate concerning the assessment of foreign deposits for FDIC insurance has merit and should continue.

Insurance Activities of Bank Holding Companies

The Administration opposes the restriction of bank holding company insurance activities as contained in S. 1720. We believe this would be an anticompetitive move contrary to our objective of equal treatment for all financial institutions.

Technical Provisions

There are several provisions of S. 1720 that are more technical in nature and can best be developed by the Congress and the regulatory agencies. Where we have special concerns regarding these provisions we will communicate our views at a later date.

Mr. Chairman, in closing I would like to thank the Committee again for offering me this opportunity to present the Treasury Department's and the Administration's views on issues relating to the financial system, issues about which I feel very strongly. I would also like to thank you, Mr. Chairman, for all of the work you have done in arranging these hearings and preparing this legislation. We would like to work closely with the Congress to secure passage of this legislation.

* * *

Mr. Chairman, that concludes my testimony. I will be pleased to answer any questions the Committee may have.

The CHAIRMAN. Thank you, Mr. Secretary.

I welcome your comments as far as going beyond this legislation. To be more specific about that, to a general review of Glass-Steagall and McFadden. That is something that I stated before, that it is not possible to get into that general review this year. I do intend to do that right after the first of the year, at the start of the second session of the 97th Congress. I'm pleased that the administration will be ready at that time to submit their comments and be prepared to testify on a much broader review of Glass-Steagall and McFadden.

So I appreciate your testimony on that.

Mr. Secretary, this past Friday afternoon, you announced that DIDC would consider postponing the half percent increase in the passbook account rates. I welcome that statement by the administration. I am one who participated in the creation of H.R. 4986 and the 6-year phaseout of Reg Q. I was one who favored a faster phaseout than the 6 years that we provided, however, when we did set up DIDC, the statement of the managers and the conversation at that time with regard to safety and as rapidly as economic conditions warrant.

So although I still favor the continued deregulation and as fast a phaseout as possible, I did feel that the timing of the 50 basis point increase was not helpful to the thrift institutions. It increased their cost of money without really giving them any additional competitiveness. A difference between $5\frac{1}{2}$ and 6 certainly didn't make them competitive with money market funds.

So I was going to question you at great length on that activity. I am sure you have preempted the entire committee from asking you many questions on that by your statement of Friday. I think I can speak for at least a majority of the committee, that we are pleased with your statement and the activity that you propose to take in that area.

Would you like to make any comments at this point?

CROSS CURRENTS IN THE ALL SAVERS CERTIFICATES

Secretary REGAN. Thank you, Mr. Chairman. I might explain just a little bit my thinking and why the change of mind, at least temporarily. First of all, there are an awful lot of cross currents going on in the market for all savers certificates and other deposits, that I don't think anyone in the country understands at the present moment. I have tried to contact leading thrift institutions as well as commercial banks, and many of their industry organizations. And no one yet has a good handle on how much of this is new money. We were quite surprised that at least initially a lot of this money was not coming out of money market funds. That was contrary to expectations of most of us as to what the source of these funds would be.

Therefore, it seemed prudent to back off on any change in passbook ceiling rates until we find out where the all saver certificates money actually is coming from. If, indeed, a great deal of it is coming from passbook savings, then there is no need for this increase in the ceiling rate, because it will not suffice to accomplish our purpose, which is to make passbook savings more competitive

with current market rates, so that they will not flow out of the institutions.

The facts remain that the thrift institutions on their liability side have to be free to compete for money in an inflationary period at or about current rates.

We have other meetings of the DIDC coming up. December is the next meeting. We can again review this subject. As we have a firmer grasp on what is going on, we can better decide whether or not we want to increase the passbook ceiling rate. Therefore, it was my suggestion to the other members of the DIDC that at least for now it was best, not to put the increase into effect on November 1.

The CHAIRMAN. You do intend to have a special meeting of DIDC then?

Secretary REGAN. No, that will be by notation vote. We've already started circulating papers on this to get the necessary signatures and votes from the DIDC members.

The CHAIRMAN. But at this point you do expect that the change will take place or at least the deferral?

Secretary REGAN. Well, assuming that everyone, except myself, votes the same way, it would come out three to two the other way.

The CHAIRMAN. It appeared that your vote switch was the only one necessary, in light of the other vote.

Mr. Secretary, my concern with DIDC also has been centered on the complexity of proposals which in my view has led to confusion among officers and employees of depository institutions and among depositors. DIDC has cut a rather wide swath restricting premiums and finder's fees, as well as proposing various phaseout schedules and new titles of certificates. So I am wondering if you could also urge DIDC in your future meetings to simplify the manner in which the phaseout will occur. I mean we centralize on the issue of passbook savings. There are a lot of other procedures that I think have been overly complex. Do you have any comments on that?

Secretary REGAN. Well, what we are attempting to do in DIDC is to try to set a long-range deregulation schedule and then allow the thrifts to stay on that schedule rather than to start and stop or have just a short-term solution not know what the long-term implications of that short-range solution might be. I would like to see us stay on the schedule. I think in most cases we are on schedules that will allow the institutions to plan their own futures. I hope that when this legislation that we're discussing now, S. 1720, is passed, and depository institutions get additional asset powers that they know where they're going to be on the liability side of their balance sheets at the same time.

The CHAIRMAN. The Chairman of the National Credit Union Administration is a member of DIDC. The new proposed chairman was before this committee on Friday, and although they are a part of DIDC, they're not subject to DIDC's decisions. I asked him on Friday whether he felt that it was fair for them to be able to participate in a decision like setting the depository accounts at 6 percent and yet go right out and set theirs at 12, if there wasn't some conflict there. He declined to answer, as not having yet been sworn in as Chairman of NCUA.

I would ask you that question. Do you think the NCUA Chairman ought to be a member of DIDC, and if he is, should he not

perhaps be a nonvoting member, like the Comptroller of the Currency?

Secretary REGAN. I haven't reflected on that, Mr. Chairman. It seems to me, as a top-of-the-head answer, that his views are appropriate to that committee. He understands the problem from a different angle. I would hate to think that a member of that committee was voting only from a narrow parochial point of view and trying to hold down competition for his own particular phase of the industry. I would think that the new Chairman could give an unbiased vote in the committee.

CREATE A LEVEL PLAYING FIELD

The CHAIRMAN. Mr. Secretary, at this point I would like a general response. Referring to your opening statement—you and I have talked about this many times, the overall need for attempting to create a level playing field. How do you see the financial services industry evolving in this country over the years ahead, given all that has transpired recently, the money market funds, over \$150 billion, all the mergers that I talked about in my opening statement, the American Express-Shearson, Prudential-Bache, and so on. How you feel that is going to evolve, and what do you believe the consequences would be for commercial banks and thrift institutions, if Congress fails to act to increase their competitiveness, as we are attempting to start that process now?

Secretary REGAN. Well, Mr. Chairman, first of all, I have to say that we have to remember that financial people are the same as manufacturers or anyone else. They are ingenious about coming up with new products, products that either there is a demand for or for which a demand can be created. I think that that will continue, not only in the 1980's and 1990's, but with new electronic advances, these new products will probably change even faster. Some of these laws that we are considering today were fashioned in an era when they never heard of advanced electronics, either for computers or for communications or for transfer of funds.

I think that we now know that that process cannot be slowed down. If we don't do something for the banks and the thrift institutions, they're going to be unnecessarily held back and other institutions are going to come in and take their place.

A thought comes to mind that we might look at the transportation industry to see what happened there, where the railroads thought they were just in the business of running railroads, and other modes of transportation came in and superseded them, trucking and the airlines. And as a result, many of our great railroads ended up in a great deal of trouble.

I think the same thing could happen in the financial services industry, if we don't keep the main portions of it, the banks and the thrift institutions, in a position where they can compete effectively. I don't think there is any way that you can slow down the ingenuity of others in the financial services industry. I don't think you would want to, even if you could. And unless you are prepared to say that the banks have had it, you are going to have to do many of the things that are not only in S. 1720, but the successive steps in years ahead, in order to keep them competitive.

And when you look at it, who is the chief beneficiary of all of this? It has to be the consumer. You get corporations of this size that are competing, and that necessarily means better service, it means faster service, it should mean cheaper service. And to the extent that the consumer is the beneficiary I think the Nation is better off.

The CHAIRMAN. Mr. Secretary, my time is up on this round. I would like to thank you for your general support of the legislation. I will look forward to working with you on the mechanics of it and changing it. I would also share your view that the market is changing so rapidly. I believe Congress would be irresponsible to sit back and do nothing and not attempt to recognize these traumatic changes that are taking place in the marketplace.

So I do thank you for the administration's support in general of this legislation. Senator Cranston?

Senator CRANSTON. Thank you very much, Mr. Chairman. Welcome, Mr. Secretary.

QUESTION WISDOM OF DIDC

Like many others, I'm very pleased that you had second thoughts about the November 1 passbook ceiling increase and decided to delay that proposal. That action does lead to questions about the wisdom of the validity of the structure of the DIDC, I think. The passbook rate increase, as I understand it, has been repeatedly considered and turned down by the DIDC, due to the earnings problems of the thrifts, the earnings problems have deteriorated since that first decision was made not to have an increase, and although you have now reversed it, I would like to ask what information you and other members of the Board had that caused you to vote for that in the first place.

Secretary REGAN. I was convinced at that time that something had to be done to stanch the flow of funds out of the thrift institutions. They were losing funds out of passbook savings rapidly. The reason had to be that they were not paying competitive interest rates, and while there was a certain basic amount that probably would stay in the institutions, gradually most of it would erode, as more and more people came to realize that 5½ percent or 5 percent does not compete effectively with 15 percent. And in an effort to make them more competitive, I wanted to take the first step, however small. And a half a percentage point increase was a small step in that direction of making them more competitive in interest rates.

We have been told that the money for all savers certificates is not coming out of the money market funds to the extent that we initially assumed it would. Later this may turn out to be a false blip or something of that nature, but at least the initial indications are that in the first week of all savers, money market funds increased rather than decreased.

To put it mildly, I'm confused as to what is going on there. I can find no one who has made any detailed study of where the money is coming from. So we decided, "We can always revisit this question. We are going to have further meetings of the DIDC, so let's back off now and see what is going on and find out if most of that

ASC money is coming from passbook savings, so that the half-percent increase isn't going to stanch that flow."

Senator CRANSTON. The DIDC changed the way the MMC rate is indexed to include a 4-week averaging process. As I understand it, that would allow financial institutions to pay a high MMC rate when interest rates are falling. How is that action going to help depository institutions? Isn't it simply going to increase their cost?

Secretary REGAN. Well, it will give them a competitive advantage over other types of instruments whose interest rates are falling, at least on a temporary basis, and to that extent, they should keep funds in there institutions. Now to the extent that the institutions can take those funds, for example, at 12 or 13 percent and translate them into other instruments on the asset side that are going to return them 15 or 16 percent, there is an arbitrage figure there that increases their earnings.

Senator CRANSTON. Can you explain why the DIDC removed all rate ceilings on IRA/Keogh accounts at its September 22 meeting, that occurred just as Congress increased the eligibility for these tax-free accounts? And it would appear to me that the action is apt to produce rate wars and increase the cost to the financial industry.

Secretary REGAN. Well, I think that the reason that we took the ceiling rates off was again to make them more competitive with others seeking these IRA and Keoghs. We want the nonbanking financial institutions to have some competition from the thrifts, and if we had not taken the ceilings off, they would not have been in a position to compete.

Senator CRANSTON. The DIDC has proposed for removing all rate ceilings on accounts of 3½ years or longer, and a proposal also for a \$5,000 minimum transaction account with no interest rate ceilings. In each of these actions, what do you believe the effect will be on the thrift industry under current conditions? And has it been considered whether it might not be wiser to wait until the whole financial sector is stronger and interest rates are lower, before we take these actions?

Secretary REGAN. Well, again, this is a judgment call. You have a good and a bad effect from this. The good effect is that by taking the ceilings off, you allow them to compete more effectively with other money market instruments. To the extent that means additional cost to them, I would submit that is probably bad. But I think the ability to compete, the ability to get new funds in, outweighs the additional cost that would result to the institutions.

REVIEW OF DIDC ACTIONS

Senator CRANSTON. Do you think it might be wise to have a 30-day review period in Congress after DIDC actions, before they actually take effect, given those affected by them an opportunity to have their say on recommended actions?

Secretary REGAN. As a practical matter, we generally do that. For example, take our most recent action with regard to increasing passbook ceilings by a half a percent. For physical reasons you cannot have something happen in DIDC on x date and then x-plus 1, put it into effect, because you have to allow time in order to

accomplish the necessary changes, to notify customers and, in fact, to notify all of the institutions.

Senator CRANSTON. I mean a 30-day review by Congress.

Secretary REGAN. Well, to the extent that the Congress wishes to get into the nitty-gritty of this type of thing. But I would submit that in all probability during this period when we are notifying institutions, if any Member of Congress were to make his views known to the DIDC, I'm sure that we could consider those views. I think if you were to hold a hearing, you might just as well have the Congress doing the work of the DIDC.

Senator CRANSTON. No, we don't want to do that.

[Laughter.]

Senator CRANSTON. The law requires that the DIDC not increase interest rates above market rates, but isn't that actually going to be the effect of some of the actions that have been taken?

Secretary REGAN. No, because money rates are competitive, and to the extent that we just free them up, we allow the institutions to compete for funds, and they will compete at the market.

Senator CRANSTON. What would you think of a proposal that would require unanimous votes of the DIDC.

Secretary REGAN. I think it would be horrible. I think that would be the same thing as asking a congressional committee to have unanimous vote. I don't think you could possibly get that. You want differences of opinion expressed, but to have everybody required to get aboard before you make a decision might prolong the discussions ad nauseam.

The CHAIRMAN. That's what happens here. And we don't even need unanimous consent.

[Laughter.]

Senator CRANSTON. On the administration's bill submitted by the Federal Home Loan Bank Board, thrifts would virtually become the same as commercial banks, allowed to invest 100 percent of their assets in nonresidential investments, such as commercial corporate business, agriculture, et cetera, loans. Presently, as you know, thrifts are limited to 20 percent of that sort.

What do you think would happen to housing financing under that proposal and who would there be to focus on housing financing?

Secretary REGAN. Well, first of all, the thrift management is going to have to make a decision here, because as a thrift goes go more toward banking, according to S. 1720, and in accordance with tax laws, it will become taxed as banks, and it will come further under banking regulation. If it wishes to stay in the housing market and continue to get that tax advantage that goes along with housing, the thrift will not change its asset structure. Now it has been my experience that most of these financial institutions as they change, usually make better than half, and probably closer to three-quarters of their efforts, in the field they know best.

The thrifts have a history of knowing the housing industry and the real estate markets. It would, in my opinion, be only logical that they stay primarily in that market. At the same time commercial banks will be encouraged to get more into the housing market, which they, in many cases, have left. We want them to come back

to help the thrifts, in order to get the housing market started again in 1982, 1983 and 1984.

So from our point of view we don't think the housing industry need fear losing the backing of the thrift industry or commercial banks. I think this is a factor more of interest rates than it is of the prerogatives that we are allowing the institutions here.

Senator CRANSTON. One final question. The chairman has indicated that he would like to pass these far-reaching measures as swiftly as possible and, if possible, before the end of the year. Would you indicate—and perhaps you would rather do this in writing than now—but if you could do it verbally, I would appreciate it.

Which of the provisions are not needed urgently, and which of the provisions are really necessary as soon as possible to address the very serious problems faced by the thrift industry at the present time?

Secretary REGAN. I would be glad to put that in writing for you, Senator.

[The following statement was received from Secretary Regan:]

In my testimony I have indicated that the Administration believes the provisions in S. 1720 that we really need swiftly are those that authorize expanded asset and liability powers for thrift institutions so that these institutions will be able to compete for funds and invest them profitably. In addition, we believe the provisions authorizing emergency interstate and interindustry mergers and acquisitions to rescue troubled depository institutions, including credit unions, are very important. The Administration has reviewed the issue of preempting state due-on-sale prohibitions and has determined that a preemption is necessary and appropriate. Finally, we strongly support the sections in S. 1720 that deal with the Glass-Steagall Act, however, we would favor putting the securities and direct real estate investment activities of depository institutions in separate affiliates. Although we believe that this would be a good time to pass the other provisions that we support in S. 1720, I have mentioned only those about which we feel particularly strongly at this time.

Secretary REGAN. I think that the Senate has a much better bill than what the House has been concentrating on, because the Senate bill offers long-range solutions to the thrift industry's problems.

Senator CRANSTON. I agree with you on that point.

Secretary REGAN. This bill addresses the short-term as well as the long-term needs of the industry and I would be glad to explain that more in a reply to this committee.

Senator CRANSTON. Thank you very much. It's been a pleasure to see you.

The CHAIRMAN. Senator Chafee?

Senator CHAFEE. Thank you very much, Mr. Chairman.

ONE-STOP SHOPPING

Mr. Secretary, last spring I introduced legislation to allow banks, thrifts, and credit unions to set up their own mutual funds and to sell shares in their own funds or the funds of other institutes. Now, the opponents have come in and said—namely, the Investment Company Institute—have said that this will lead to an excessive concentration of power, giving the banks an unfair advantage over other institutions. Primarily they are thinking this would be one-stop shopping, and thus the tilt will go and the playing field will not be even, as far as the investment companies are concerned. Could I have your thoughts on that?

Secretary REGAN. Certainly, Senator. I will try to make it brief, although it is really a complex answer.

The way that we are proposing this is that a bank holding company set up a security subsidiary within that holding company, and that subsidiary be the equivalent of a securities industry corporation or partnership. We see no unfair advantage that would result, just more competition. Now, the securities industry can hardly say that more competition is unfair, unless they are closet cartelists. I would suggest that they should welcome competition, because this is in the true sense of American capitalism.

There are many people who are concerned about the capital raising abilities of the securities industry. I think this is a step in helping resolve that concern. We have many large securities companies, many of whom are going to be backed by companies that have more earning power in finance—for example, Sears earns more in finance than most banks and so does Prudential. To the extent that they are now going to be competing with banks, I don't think that the securities industry can say that it is unfair competition to allow banks to compete with Sears and/or American Express or Prudential. I think that it makes more sense to let banks into it.

I think the customer will benefit here; if a customer wants to buy mutual funds or money market funds from a bank, why not? What's wrong with that? So from my point of view, I say the more the merrier and the more competition, the better off the entire industry will be.

Senator CHAFEE. Well, I certainly agree with you on that. My problem is with the administration's proposal about this separate company that you are talking about. Banks currently, of course, invest trusts, guardianship and State accounts, individually and collectively. They handle agency accounts individually. They underwrite general obligation municipal bonds, and of course they invest for their own account in municipal revenue bonds. That is, the bank invests for its own account. And it seems to me to impose this elaborate structure on top of it presents a problem, an added impediment if you want, and I'm particularly thinking of the smaller banks.

I wonder if this isn't something a little extra that they will have to wrestle with in getting into a holding company. I suppose one of the questions is will the ability to go into a holding company be freely granted, and secondly, to set up a separate mechanism when already they are doing an awful lot of it. Would the agency accounts have to be moved over, for example, into this separate entity?

Secretary REGAN. Well, answering your last question first; no. What we are saying here is strictly whatever securities activities the bank is going to perform—and again, this is voluntary—a bank doesn't have to do this—but if the bank chooses to do it—

Senator CHAFEE. To get into the money market?

REVENUE BONDS

Secretary REGAN. To get into underwriting revenue bonds and the like. We say, OK, set up a separate subsidiary, because if you don't, first, a bank would have unfair tax advantages. A bank on

its municipal portfolio and its holdings of either revenue bonds or tax-exempt mutual funds, while they're waiting to be sold, would have tax advantages over a securities company.

Secondly, they might, because they were part of the bank, be able to get money at more favorable rates than a securities firm would be able to get it. A securities firm has to pay whatever the brokers' loan rate is. Sometimes interbank funds are much lower than the bank's brokers' loan rate. Therefore if the bank were to loan to its own department in the securities business at the current bank rate, the securities activity would have an advantage.

Thirdly, and most important we want to safeguard the FDIC funds. We in the Federal Government have to think through what the effect is of what we are doing. If these things prove risky, and if they put the bank in jeopardy, the FDIC has to step in. That has budgetary implications.

We are saying insulate the bank and its insurance feature, and from the securities affiliate that is taking more risks. If something happens in that securities affiliate, it need not impact the bank itself.

Senator CHAFEE. I agree with the general approach here. My bill doesn't directly provide for FDIC insurance, although I suppose the bank might be lending.

Secretary REGAN. Well, that's exactly the point, Senator. We have found that when the FDIC steps in to rescue a bank, for whatever reason the bank is having trouble, they bail out everybody. And we don't think that the bank's stockholders should be bailed out if the bank voluntarily assumes risks in a different field.

Senator CHAFEE. Why aren't you prepared to give the same power to the thrifts, to the S. & L.'s, and to the credit unions? It seems to me you are exacerbating the problems that they are running into already if you don't let them compete in this field that is going to involve the commercial banks so extensively.

Secretary REGAN. We are well aware that there seems to be a dichotomy here, but what we're actually trying to do, Senator, is say, look, we're giving them a lot of new powers through S. 1720: the ability to make commercial loans; the ability to make consumer loans; various other things of that nature. That being the case, we don't want to force too much on to them all at once. We have said that we would be more than happy to revisit the question of additional powers in a while after they have gained experience with the new powers that make them more like banks. In the meantime, rather than hold the banks back, we have said let the banks go ahead into the securities business. I doubt, in all honesty, if there are many thrifts that really want to step into securities underwriting either revenue bonds, general obligation bonds, or mutual funds at this particular moment.

Senator CHAFEE. Some of those thrifts are pretty large and have a lot of managerial talent, and they might want to do it. Well, thank you very much, Mr. Secretary.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, Senator Proxmire is next and has some questions. He just had a phone call, and I might just ask you a question or two until he gets back.

Your statement proposes requiring a bank to form a holding company, as we have been discussing at quite great length here, and charter a separate subsidiary of that holding company for the bank to be able to offer mutual funds to its customers. Getting into the one bank holding company issue, this would be a significant expense for a smaller bank. Do you see any possibility to enable a smaller bank to act at least as an agent for a mutual fund, without incurring this expense and at the same time, without creating an unfair competitive advantage or undue additional risk for the FDIC? In other words, I'm looking at a mechanism that we might explore. I don't expect a final answer from you today, but hope to explore the concept primarily for the smaller institutions.

Secretary REGAN. I think that is a possibility, Senator. A bank below a certain size might be able to conduct securities business in some method other than through a bank holding company. I'm suggesting the use of a bank holding company primarily by the larger banks. It has been my experience that the large or medium-size bank that would want to get into the underwriting of these particular types of issues probably would want to engage in other types of securities activities as time goes on. I am proposing the holding company approach for the long range future.

For a small bank in a small town wanting to get into a syndicate merely to underwrite a particular revenue bond or offer a money market fund, there should be some way to do so other than through a holding company.

The CHAIRMAN. Well, I would like to work with you on that issue because I think, as many people know, many of the smaller banks, particularly the independent banks, are not too enthralled with the one-bank holding company idea.

Secretary REGAN. I understand.

The CHAIRMAN. Senator Proxmire?

RECONSTITUTING THE DIDC

Senator PROXMIRE. Mr. Secretary, as one of the authors of the phaseout, I sympathize with the dilemma that you are in. We had no idea, of course, that we would have anything like the economic conditions we have. We certainly didn't visualize the terrific rise in interest rates and what that would do to the financial institutions. We did try to stress at that time that the phaseout should take into full account the safety and soundness of the institutions involved under those circumstances, and I realize that it is difficult for you to answer, perhaps. What would you think of our reconstituting DIDC to drop the presence of Treasury as well as the NCUA, and have it include only the Fed, the FDIC, and the Home Loan Bank Board as the agencies that provide liquidity insurance for the financial system and have a direct stake?

Secretary REGAN. I will speak for Treasury, primarily. We have a point of view that is worth listening to and Treasury also, of course, is part of the regulating system, since the Comptroller of the Currency reports to the Secretary of the Treasury and he is a regulator. Therefore, I think we have as much interest in the work of the DIDC as anyone. In addition, the Treasury has a broad point of view on what is going on in the financial markets. I think Treasury should have a representative on the committee.

Senator PROXMIRE. Well, I sympathize with that, but at the same time it just seems to me that Treasury has the kind of independent voice there, but they don't have the same concern for the safety and soundness. And that is, of course, one of the center points of that legislation.

Secretary REGAN. If I might demur from that, I think Treasury is every bit as concerned with the financial soundness of the banking system, whether it be thrifts or commercial banks, and I think that we are pretty sensible about that responsibility. It may be that some people think I am a bit of a firebrand and might want to deregulate a little bit faster than others, but nonetheless I think we do proceed with deliberate caution.

Senator PROXMIRE. Well, let me just go over some of the other points that not only the half percent increase in passbook rate, which I think, as the chairman pointed out obviously isn't going to make the savings and loans any more competitive with the 15 percent interest; 6 percent interest, if anything, would call attention to the people who have money with the savings and loans and make them aware of the fact that sure, they're getting 6 percent now, but for heaven's sake, they're foolish not to get 15 percent.

But the other provisions, changing the 6-month MMC index effective November 1, I understand the cost of that to S. & L.'s will be \$300 million, creating an IRA/Keogh wildcard. And the cost of that, it is argued, could be as bad as both the MMC index change and the passbook rate, allowing the payment of brokerage fees on all savers certificates so that the S. & L.'s have to pay brokerage fees.

I wonder if those don't do serious damage to the savings and loans. After all, we passed this with the idea that we were going to be evenhanded, and I thought we were giving savings and loans an opportunity. I wanted them to have a chance to compete more effectively, and that was the reason we passed this legislation. These decisions by DIDC, it seems to me, make it very difficult, especially in aggregate.

Secretary REGAN. Well, again, this is a good-news, bad-news situation. If we keep restrictions on their money market certificates, if we keep restrictions on what they can pay for IRA and Keogh accounts and, on the other hand, other financial institutions are free to offer instruments that are the equivalent of what depository institutions can offer but have much more attractive rates of interest, certainly money will flow out of the thrifts and banks.

Senator PROXMIRE. What advantage do they get out of paying brokerage fees?

Secretary REGAN. Well, many of the large brokerage firms have made arrangements with thrift institutions to collect funds for them and to send the funds to the institutions. The thrift institutions are not in touch with a wide variety of customers to get new money for their All Savers accounts. The brokerage firms on Wall Street are finding their own customers who want to go into All Savers Certificates, who might not have heard of them, and are encouraging them to do so. The brokerage firms are acting as a collection agency.

Senator PROXMIRE. The representatives of the savings and loan, or the expert regulators, the Home Loan Bank Board, they favor this brokerage fee?

Secretary REGAN. The S. & L.'s actually wanted this brokerage service and the Federal Home Loan Bank Board staff had no objection.

Senator PROXMIRE. They did support it?

Secretary REGAN. They did support it.

Senator PROXMIRE. Well, I wonder if they still would. I doubt it, from what I've heard. But anyway, let me ask one other question because I think this is really the fundamental problem we have here. The thrifts are very important to all of us, of course, and we want to do all we can to preserve them. I think they are very important institutions, certainly in all of our States. At the same time, the reason for the thrifts is to support housing, and I wonder if this legislation that is before us today wouldn't, in effect, just walk away from that special function that thrifts have performed very well over the last many years and create a situation in which home buyers and homebuilders just wouldn't have a financial institution which would provide the kind of service that thrifts have in the past at the price they have in the past with the expertise they have in the past.

SACRIFICE TAX ADVANTAGES

Secretary REGAN. Well, at the risk of being repetitious, Senator, I am convinced that they would not immediately turn away from the housing industry and get into those other powers. Look at what they would do if they were to do that. First of all, they would sacrifice many of their tax advantages. You know the tax situation of thrifts as well as I do, so I won't bother to review that but the more they get into other asset powers, the less tax advantage they would have.

Second, most of the people within the thrift industry—management and the like—are primarily concerned with the housing industry. I don't think they are going to turn their backs on the industry immediately and walk away from it. At the same time, we are encouraging commercial banks to come back into the housing market which they have abandoned over the past few years. I think the combination will give as much money to the housing industry as it could possibly want, when the price of money gets to where the housing industry can use it.

Frankly what's wrong with the housing industry at this point is price, the price of money. It is too high to make profits in building houses, but as soon as we can get interest rates down, then I think the housing industry—

Senator PROXMIRE. Well, of course, you're absolutely right. The fundamental problem is the interest rates right now. But I am just afraid when that problem is gone, that we will have lost much of the great advantage to housing that savings and loans provided. I was disturbed—you are an extraordinarily articulate and intelligent man, I think one of the ablest people in the administration without any question, but you said immediately turn away—you wouldn't expect them to immediately turn away and immediately abandon the expertise they have in housing. The implication was

The CHAIRMAN. Thank you, Mr. Secretary.

I welcome your comments as far as going beyond this legislation. To be more specific about that, to a general review of Glass-Steagall and McFadden. That is something that I stated before, that it is not possible to get into that general review this year. I do intend to do that right after the first of the year, at the start of the second session of the 97th Congress. I'm pleased that the administration will be ready at that time to submit their comments and be prepared to testify on a much broader review of Glass-Steagall and McFadden.

So I appreciate your testimony on that.

Mr. Secretary, this past Friday afternoon, you announced that DIDC would consider postponing the half percent increase in the passbook account rates. I welcome that statement by the administration. I am one who participated in the creation of H.R. 4986 and the 6-year phaseout of Reg Q. I was one who favored a faster phaseout than the 6 years that we provided, however, when we did set up DIDC, the statement of the managers and the conversation at that time with regard to safety and as rapidly as economic conditions warrant.

So although I still favor the continued deregulation and as fast a phaseout as possible, I did feel that the timing of the 50 basis point increase was not helpful to the thrift institutions. It increased their cost of money without really giving them any additional competitiveness. A difference between $5\frac{1}{2}$ and 6 certainly didn't make them competitive with money market funds.

So I was going to question you at great length on that activity. I am sure you have preempted the entire committee from asking you many questions on that by your statement of Friday. I think I can speak for at least a majority of the committee, that we are pleased with your statement and the activity that you propose to take in that area.

Would you like to make any comments at this point?

CROSS CURRENTS IN THE ALL SAVERS CERTIFICATES

Secretary REGAN. Thank you, Mr. Chairman. I might explain just a little bit my thinking and why the change of mind, at least temporarily. First of all, there are an awful lot of cross currents going on in the market for all savers certificates and other deposits, that I don't think anyone in the country understands at the present moment. I have tried to contact leading thrift institutions as well as commercial banks, and many of their industry organizations. And no one yet has a good handle on how much of this is new money. We were quite surprised that at least initially a lot of this money was not coming out of money market funds. That was contrary to expectations of most of us as to what the source of these funds would be.

Therefore, it seemed prudent to back off on any change in passbook ceiling rates until we find out where the all saver certificates money actually is coming from. If, indeed, a great deal of it is coming from passbook savings, then there is no need for this increase in the ceiling rate, because it will not suffice to accomplish our purpose, which is to make passbook savings more competitive

with current market rates, so that they will not flow out of the institutions.

The facts remain that the thrift institutions on their liability side have to be free to compete for money in an inflationary period at or about current rates.

We have other meetings of the DIDC coming up. December is the next meeting. We can again review this subject. As we have a firmer grasp on what is going on, we can better decide whether or not we want to increase the passbook ceiling rate. Therefore, it was my suggestion to the other members of the DIDC that at least for now it was best, not to put the increase into effect on November 1.

The CHAIRMAN. You do intend to have a special meeting of DIDC then?

Secretary REGAN. No, that will be by notation vote. We've already started circulating papers on this to get the necessary signatures and votes from the DIDC members.

The CHAIRMAN. But at this point you do expect that the change will take place or at least the deferral?

Secretary REGAN. Well, assuming that everyone, except myself, votes the same way, it would come out three to two the other way.

The CHAIRMAN. It appeared that your vote switch was the only one necessary, in light of the other vote.

Mr. Secretary, my concern with DIDC also has been centered on the complexity of proposals which in my view has led to confusion among officers and employees of depository institutions and among depositors. DIDC has cut a rather wide swath restricting premiums and finder's fees, as well as proposing various phaseout schedules and new titles of certificates. So I am wondering if you could also urge DIDC in your future meetings to simplify the manner in which the phaseout will occur. I mean we centralize on the issue of passbook savings. There are a lot of other procedures that I think have been overly complex. Do you have any comments on that?

Secretary REGAN. Well, what we are attempting to do in DIDC is to try to set a long-range deregulation schedule and then allow the thrifts to stay on that schedule rather than to start and stop or have just a short-term solution not know what the long-term implications of that short-range solution might be. I would like to see us stay on the schedule. I think in most cases we are on schedules that will allow the institutions to plan their own futures. I hope that when this legislation that we're discussing now, S. 1720, is passed, and depository institutions get additional asset powers that they know where they're going to be on the liability side of their balance sheets at the same time.

The CHAIRMAN. The Chairman of the National Credit Union Administration is a member of DIDC. The new proposed chairman was before this committee on Friday, and although they are a part of DIDC, they're not subject to DIDC's decisions. I asked him on Friday whether he felt that it was fair for them to be able to participate in a decision like setting the depository accounts at 6 percent and yet go right out and set theirs at 12, if there wasn't some conflict there. He declined to answer, as not having yet been sworn in as Chairman of NCUA.

I would ask you that question. Do you think the NCUA Chairman ought to be a member of DIDC, and if he is, should he not

perhaps be a nonvoting member, like the Comptroller of the Currency?

Secretary REGAN. I haven't reflected on that, Mr. Chairman. It seems to me, as a top-of-the-head answer, that his views are appropriate to that committee. He understands the problem from a different angle. I would hate to think that a member of that committee was voting only from a narrow parochial point of view and trying to hold down competition for his own particular phase of the industry. I would think that the new Chairman could give an unbiased vote in the committee.

CREATE A LEVEL PLAYING FIELD

The CHAIRMAN. Mr. Secretary, at this point I would like a general response. Referring to your opening statement—you and I have talked about this many times, the overall need for attempting to create a level playing field. How do you see the financial services industry evolving in this country over the years ahead, given all that has transpired recently, the money market funds, over \$150 billion, all the mergers that I talked about in my opening statement, the American Express-Shearson, Prudential-Bache, and so on. How you feel that is going to evolve, and what do you believe the consequences would be for commercial banks and thrift institutions, if Congress fails to act to increase their competitiveness, as we are attempting to start that process now?

Secretary REGAN. Well, Mr. Chairman, first of all, I have to say that we have to remember that financial people are the same as manufacturers or anyone else. They are ingenious about coming up with new products, products that either there is a demand for or for which a demand can be created. I think that that will continue, not only in the 1980's and 1990's, but with new electronic advances, these new products will probably change even faster. Some of these laws that we are considering today were fashioned in an era when they never heard of advanced electronics, either for computers or for communications or for transfer of funds.

I think that we now know that that process cannot be slowed down. If we don't do something for the banks and the thrift institutions, they're going to be unnecessarily held back and other institutions are going to come in and take their place.

A thought comes to mind that we might look at the transportation industry to see what happened there, where the railroads thought they were just in the business of running railroads, and other modes of transportation came in and superseded them, trucking and the airlines. And as a result, many of our great railroads ended up in a great deal of trouble.

I think the same thing could happen in the financial services industry, if we don't keep the main portions of it, the banks and the thrift institutions, in a position where they can compete effectively. I don't think there is any way that you can slow down the ingeniousness of others in the financial services industry. I don't think you would want to, even if you could. And unless you are prepared to say that the banks have had it, you are going to have to do many of the things that are not only in S. 1720, but the successive steps in years ahead, in order to keep them competitive.

And when you look at it, who is the chief beneficiary of all of this? It has to be the consumer. You get corporations of this size that are competing, and that necessarily means better service, it means faster service, it should mean cheaper service. And to the extent that the consumer is the beneficiary I think the Nation is better off.

The CHAIRMAN. Mr. Secretary, my time is up on this round. I would like to thank you for your general support of the legislation. I will look forward to working with you on the mechanics of it and changing it. I would also share your view that the market is changing so rapidly. I believe Congress would be irresponsible to sit back and do nothing and not attempt to recognize these traumatic changes that are taking place in the marketplace.

So I do thank you for the administration's support in general of this legislation. Senator Cranston?

Senator CRANSTON. Thank you very much, Mr. Chairman. Welcome, Mr. Secretary.

QUESTION WISDOM OF DIDC

Like many others, I'm very pleased that you had second thoughts about the November 1 passbook ceiling increase and decided to delay that proposal. That action does lead to questions about the wisdom of the validity of the structure of the DIDC, I think. The passbook rate increase, as I understand it, has been repeatedly considered and turned down by the DIDC, due to the earnings problems of the thrifts, the earnings problems have deteriorated since that first decision was made not to have an increase, and although you have now reversed it, I would like to ask what information you and other members of the Board had that caused you to vote for that in the first place.

Secretary REGAN. I was convinced at that time that something had to be done to stanch the flow of funds out of the thrift institutions. They were losing funds out of passbook savings rapidly. The reason had to be that they were not paying competitive interest rates, and while there was a certain basic amount that probably would stay in the institutions, gradually most of it would erode, as more and more people came to realize that 5½ percent or 5 percent does not compete effectively with 15 percent. And in an effort to make them more competitive, I wanted to take the first step, however small. And a half a percentage point increase was a small step in that direction of making them more competitive in interest rates.

We have been told that the money for all savers certificates is not coming out of the money market funds to the extent that we initially assumed it would. Later this may turn out to be a false blip or something of that nature, but at least the initial indications are that in the first week of all savers, money market funds increased rather than decreased.

To put it mildly, I'm confused as to what is going on there. I can find no one who has made any detailed study of where the money is coming from. So we decided, "We can always revisit this question. We are going to have further meetings of the DIDC, so let's back off now to see what is going on and find out if most of that

ASC money is coming from passbook savings, so that the half-percent increase isn't going to stanch that flow."

Senator CRANSTON. The DIDC changed the way the MMC rate is indexed to include a 4-week averaging process. As I understand it, that would allow financial institutions to pay a high MMC rate when interest rates are falling. How is that action going to help depository institutions? Isn't it simply going to increase their cost?

Secretary REGAN. Well, it will give them a competitive advantage over other types of instruments whose interest rates are falling, at least on a temporary basis, and to that extent, they should keep funds in there institutions. Now to the extent that the institutions can take those funds, for example, at 12 or 13 percent and translate them into other instruments on the asset side that are going to return them 15 or 16 percent, there is an arbitrage figure there that increases their earnings.

Senator CRANSTON. Can you explain why the DIDC removed all rate ceilings on IRA/Keogh accounts at its September 22 meeting, that occurred just as Congress increased the eligibility for these tax-free accounts? And it would appear to me that the action is apt to produce rate wars and increase the cost to the financial industry.

Secretary REGAN. Well, I think that the reason that we took the ceiling rates off was again to make them more competitive with others seeking these IRA and Keoghs. We want the nonbanking financial institutions to have some competition from the thrifts, and if we had not taken the ceilings off, they would not have been in a position to compete.

Senator CRANSTON. The DIDC has proposed for removing all rate ceilings on accounts of 3½ years or longer, and a proposal also for a \$5,000 minimum transaction account with no interest rate ceilings. In each of these actions, what do you believe the effect will be on the thrift industry under current conditions? And has it been considered whether it might not be wiser to wait until the whole financial sector is stronger and interest rates are lower, before we take these actions?

Secretary REGAN. Well, again, this is a judgment call. You have a good and a bad effect from this. The good effect is that by taking the ceilings off, you allow them to compete more effectively with other money market instruments. To the extent that means additional cost to them, I would submit that is probably bad. But I think the ability to compete, the ability to get new funds in, outweighs the additional cost that would result to the institutions.

REVIEW OF DIDC ACTIONS

Senator CRANSTON. Do you think it might be wise to have a 30-day review period in Congress after DIDC actions, before they actually take effect, given those affected by them an opportunity to have their say on recommended actions?

Secretary REGAN. As a practical matter, we generally do that. For example, take our most recent action with regard to increasing passbook ceilings by a half a percent. For physical reasons you cannot have something happen in DIDC on x date and then x-plus 1, put it into effect, because you have to allow time in order to

accomplish the necessary changes, to notify customers and, in fact, to notify all of the institutions.

Senator CRANSTON. I mean a 30-day review by Congress.

Secretary REGAN. Well, to the extent that the Congress wishes to get into the nitty-gritty of this type of thing. But I would submit that in all probability during this period when we are notifying institutions, if any Member of Congress were to make his views known to the DIDC, I'm sure that we could consider those views. I think if you were to hold a hearing, you might just as well have the Congress doing the work of the DIDC.

Senator CRANSTON. No, we don't want to do that.

[Laughter.]

Senator CRANSTON. The law requires that the DIDC not increase interest rates above market rates, but isn't that actually going to be the effect of some of the actions that have been taken?

Secretary REGAN. No, because money rates are competitive, and to the extent that we just free them up, we allow the institutions to compete for funds, and they will compete at the market.

Senator CRANSTON. What would you think of a proposal that would require unanimous votes of the DIDC.

Secretary REGAN. I think it would be horrible. I think that would be the same thing as asking a congressional committee to have unanimous vote. I don't think you could possibly get that. You want differences of opinion expressed, but to have everybody required to get aboard before you make a decision might prolong the discussions ad nauseam.

The CHAIRMAN. That's what happens here. And we don't even need unanimous consent.

[Laughter.]

Senator CRANSTON. On the administration's bill submitted by the Federal Home Loan Bank Board, thrifts would virtually become the same as commercial banks, allowed to invest 100 percent of their assets in nonresidential investments, such as commercial corporate business, agriculture, et cetera, loans. Presently, as you know, thrifts are limited to 20 percent of that sort.

What do you think would happen to housing financing under that proposal and who would there be to focus on housing financing?

Secretary REGAN. Well, first of all, the thrift management is going to have to make a decision here, because as a thrift goes go more toward banking, according to S. 1720, and in accordance with tax laws, it will become taxed as banks, and it will come further under banking regulation. If it wishes to stay in the housing market and continue to get that tax advantage that goes along with housing, the thrift will not change its asset structure. Now it has been my experience that most of these financial institutions as they change, usually make better than half, and probably closer to three-quarters of their efforts, in the field they know best.

The thrifts have a history of knowing the housing industry and the real estate markets. It would, in my opinion, be only logical that they stay primarily in that market. At the same time commercial banks will be encouraged to get more into the housing market, which they, in many cases, have left. We want them to come back

to help the thrifts, in order to get the housing market started again in 1982, 1983 and 1984.

So from our point of view we don't think the housing industry need fear losing the backing of the thrift industry or commercial banks. I think this is a factor more of interest rates than it is of the prerogatives that we are allowing the institutions here.

Senator CRANSTON. One final question. The chairman has indicated that he would like to pass these far-reaching measures as swiftly as possible and, if possible, before the end of the year. Would you indicate—and perhaps you would rather do this in writing than now—but if you could do it verbally, I would appreciate it.

Which of the provisions are not needed urgently, and which of the provisions are really necessary as soon as possible to address the very serious problems faced by the thrift industry at the present time?

Secretary REGAN. I would be glad to put that in writing for you, Senator.

[The following statement was received from Secretary Regan:]

In my testimony I have indicated that the Administration believes the provisions in S. 1720 that we really need swiftly are those that authorize expanded asset and liability powers for thrift institutions so that these institutions will be able to compete for funds and invest them profitably. In addition, we believe the provisions authorizing emergency interstate and interindustry mergers and acquisitions to rescue troubled depository institutions, including credit unions, are very important. The Administration has reviewed the issue of preempting state due-on-sale prohibitions and has determined that a preemption is necessary and appropriate. Finally, we strongly support the sections in S. 1720 that deal with the Glass-Steagall Act, however, we would favor putting the securities and direct real estate investment activities of depository institutions in separate affiliates. Although we believe that this would be a good time to pass the other provisions that we support in S. 1720, I have mentioned only those about which we feel particularly strongly at this time.

Secretary REGAN. I think that the Senate has a much better bill than what the House has been concentrating on, because the Senate bill offers long-range solutions to the thrift industry's problems.

Senator CRANSTON. I agree with you on that point.

Secretary REGAN. This bill addresses the short-term as well as the long-term needs of the industry and I would be glad to explain that more in a reply to this committee.

Senator CRANSTON. Thank you very much. It's been a pleasure to see you.

The CHAIRMAN. Senator Chafee?

Senator CHAFEE. Thank you very much, Mr. Chairman.

ONE-STOP SHOPPING

Mr. Secretary, last spring I introduced legislation to allow banks, thrifts, and credit unions to set up their own mutual funds and to sell shares in their own funds or the funds of other institutes. Now, the opponents have come in and said—namely, the Investment Company Institute—have said that this will lead to an excessive concentration of power, giving the banks an unfair advantage over other institutions. Primarily they are thinking this would be one-stop shopping, and thus the tilt will go and the playing field will not be even, as far as the investment companies are concerned. Could I have your thoughts on that?

Secretary REGAN. Certainly, Senator. I will try to make it brief, although it is really a complex answer.

The way that we are proposing this is that a bank holding company set up a security subsidiary within that holding company, and that subsidiary be the equivalent of a securities industry corporation or partnership. We see no unfair advantage that would result, just more competition. Now, the securities industry can hardly say that more competition is unfair, unless they are closet cartelists. I would suggest that they should welcome competition, because this is in the true sense of American capitalism.

There are many people who are concerned about the capital raising abilities of the securities industry. I think this is a step in helping resolve that concern. We have many large securities companies, many of whom are going to be backed by companies that have more earning power in finance—for example, Sears earns more in finance than most banks and so does Prudential. To the extent that they are now going to be competing with banks, I don't think that the securities industry can say that it is unfair competition to allow banks to compete with Sears and/or American Express or Prudential. I think that it makes more sense to let banks into it.

I think the customer will benefit here; if a customer wants to buy mutual funds or money market funds from a bank, why not? What's wrong with that? So from my point of view, I say the more the merrier and the more competition, the better off the entire industry will be.

Senator CHAFEE. Well, I certainly agree with you on that. My problem is with the administration's proposal about this separate company that you are talking about. Banks currently, of course, invest trusts, guardianship and State accounts, individually and collectively. They handle agency accounts individually. They underwrite general obligation municipal bonds, and of course they invest for their own account in municipal revenue bonds. That is, the bank invests for its own account. And it seems to me to impose this elaborate structure on top of it presents a problem, an added impediment if you want, and I'm particularly thinking of the smaller banks.

I wonder if this isn't something a little extra that they will have to wrestle with in getting into a holding company. I suppose one of the questions is will the ability to go into a holding company be freely granted, and secondly, to set up a separate mechanism when already they are doing an awful lot of it. Would the agency accounts have to be moved over, for example, into this separate entity?

Secretary REGAN. Well, answering your last question first; no. What we are saying here is strictly whatever securities activities the bank is going to perform—and again, this is voluntary—a bank doesn't have to do this—but if the bank chooses to do it—

Senator CHAFEE. To get into the money market?

REVENUE BONDS

Secretary REGAN. To get into underwriting revenue bonds and the like. We say, OK, set up a separate subsidiary, because if you don't, first, a bank would have unfair tax advantages. A bank on

its municipal portfolio and its holdings of either revenue bonds or tax-exempt mutual funds, while they're waiting to be sold, would have tax advantages over a securities company.

Secondly, they might, because they were part of the bank, be able to get money at more favorable rates than a securities firm would be able to get it. A securities firm has to pay whatever the brokers' loan rate is. Sometimes interbank funds are much lower than the bank's brokers' loan rate. Therefore if the bank were to loan to its own department in the securities business at the current bank rate, the securities activity would have an advantage.

Thirdly, and most important we want to safeguard the FDIC funds. We in the Federal Government have to think through what the effect is of what we are doing. If these things prove risky, and if they put the bank in jeopardy, the FDIC has to step in. That has budgetary implications.

We are saying insulate the bank and its insurance feature, and from the securities affiliate that is taking more risks. If something happens in that securities affiliate, it need not impact the bank itself.

Senator CHAFEE. I agree with the general approach here. My bill doesn't directly provide for FDIC insurance, although I suppose the bank might be lending.

Secretary REGAN. Well, that's exactly the point, Senator. We have found that when the FDIC steps in to rescue a bank, for whatever reason the bank is having trouble, they bail out everybody. And we don't think that the bank's stockholders should be bailed out if the bank voluntarily assumes risks in a different field.

Senator CHAFEE. Why aren't you prepared to give the same power to the thrifts, to the S. & L.'s, and to the credit unions? It seems to me you are exacerbating the problems that they are running into already if you don't let them compete in this field that is going to involve the commercial banks so extensively.

Secretary REGAN. We are well aware that there seems to be a dichotomy here, but what we're actually trying to do, Senator, is say, look, we're giving them a lot of new powers through S. 1720: the ability to make commercial loans; the ability to make consumer loans; various other things of that nature. That being the case, we don't want to force too much on to them all at once. We have said that we would be more than happy to revisit the question of additional powers in a while after they have gained experience with the new powers that make them more like banks. In the meantime, rather than hold the banks back, we have said let the banks go ahead into the securities business. I doubt, in all honesty, if there are many thrifts that really want to step into securities underwriting either revenue bonds, general obligation bonds, or mutual funds at this particular moment.

Senator CHAFEE. Some of those thrifts are pretty large and have a lot of managerial talent, and they might want to do it. Well, thank you very much, Mr. Secretary.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, Senator Proxmire is next and has some questions. He just had a phone call, and I might just ask you a question or two until he gets back.

Your statement proposes requiring a bank to form a holding company, as we have been discussing at quite great length here, and charter a separate subsidiary of that holding company for the bank to be able to offer mutual funds to its customers. Getting into the one bank holding company issue, this would be a significant expense for a smaller bank. Do you see any possibility to enable a smaller bank to act at least as an agent for a mutual fund, without incurring this expense and at the same time, without creating an unfair competitive advantage or undue additional risk for the FDIC? In other words, I'm looking at a mechanism that we might explore. I don't expect a final answer from you today, but hope to explore the concept primarily for the smaller institutions.

Secretary REGAN. I think that is a possibility, Senator. A bank below a certain size might be able to conduct securities business in some method other than through a bank holding company. I'm suggesting the use of a bank holding company primarily by the larger banks. It has been my experience that the large or medium-size bank that would want to get into the underwriting of these particular types of issues probably would want to engage in other types of securities activities as time goes on. I am proposing the holding company approach for the long range future.

For a small bank in a small town wanting to get into a syndicate merely to underwrite a particular revenue bond or offer a money market fund, there should be some way to do so other than through a holding company.

The CHAIRMAN. Well, I would like to work with you on that issue because I think, as many people know, many of the smaller banks, particularly the independent banks, are not too enthralled with the one-bank holding company idea.

Secretary REGAN. I understand.

The CHAIRMAN. Senator Proxmire?

RECONSTITUTING THE DIDC

Senator PROXMIRE. Mr. Secretary, as one of the authors of the phaseout, I sympathize with the dilemma that you are in. We had no idea, of course, that we would have anything like the economic conditions we have. We certainly didn't visualize the terrific rise in interest rates and what that would do to the financial institutions. We did try to stress at that time that the phaseout should take into full account the safety and soundness of the institutions involved under those circumstances, and I realize that it is difficult for you to answer, perhaps. What would you think of our reconstituting DIDC to drop the presence of Treasury as well as the NCUA, and have it include only the Fed, the FDIC, and the Home Loan Bank Board as the agencies that provide liquidity insurance for the financial system and have a direct stake?

Secretary REGAN. I will speak for Treasury, primarily. We have a point of view that is worth listening to and Treasury also, of course, is part of the regulating system, since the Comptroller of the Currency reports to the Secretary of the Treasury and he is a regulator. Therefore, I think we have as much interest in the work of the DIDC as anyone. In addition, the Treasury has a broad point of view on what is going on in the financial markets. I think Treasury should have a representative on the committee.

Senator PROXMIRE. Well, I sympathize with that, but at the same time it just seems to me that Treasury has the kind of independent voice there, but they don't have the same concern for the safety and soundness. And that is, of course, one of the center points of that legislation.

Secretary REGAN. If I might demur from that, I think Treasury is every bit as concerned with the financial soundness of the banking system, whether it be thrifts or commercial banks, and I think that we are pretty sensible about that responsibility. It may be that some people think I am a bit of a firebrand and might want to deregulate a little bit faster than others, but nonetheless I think we do proceed with deliberate caution.

Senator PROXMIRE. Well, let me just go over some of the other points that not only the half percent increase in passbook rate, which I think, as the chairman pointed out obviously isn't going to make the savings and loans any more competitive with the 15 percent interest; 6 percent interest, if anything, would call attention to the people who have money with the savings and loans and make them aware of the fact that sure, they're getting 6 percent now, but for heaven's sake, they're foolish not to get 15 percent.

But the other provisions, changing the 6-month MMC index effective November 1, I understand the cost of that to S. & L.'s will be \$300 million, creating an IRA/Keogh wildcard. And the cost of that, it is argued, could be as bad as both the MMC index change and the passbook rate, allowing the payment of brokerage fees on all savers certificates so that the S. & L.'s have to pay brokerage fees.

I wonder if those don't do serious damage to the savings and loans. After all, we passed this with the idea that we were going to be evenhanded, and I thought we were giving savings and loans an opportunity. I wanted them to have a chance to compete more effectively, and that was the reason we passed this legislation. These decisions by DIDC, it seems to me, make it very difficult, especially in aggregate.

Secretary REGAN. Well, again, this is a good-news, bad-news situation. If we keep restrictions on their money market certificates, if we keep restrictions on what they can pay for IRA and Keogh accounts and, on the other hand, other financial institutions are free to offer instruments that are the equivalent of what depository institutions can offer but have much more attractive rates of interest, certainly money will flow out of the thrifts and banks.

Senator PROXMIRE. What advantage do they get out of paying brokerage fees?

Secretary REGAN. Well, many of the large brokerage firms have made arrangements with thrift institutions to collect funds for them and to send the funds to the institutions. The thrift institutions are not in touch with a wide variety of customers to get new money for their All Savers accounts. The brokerage firms on Wall Street are finding their own customers who want to go into All Savers Certificates, who might not have heard of them, and are encouraging them to do so. The brokerage firms are acting as a collection agency.

Senator PROXMIRE. The representatives of the savings and loan, or the expert regulators, the Home Loan Bank Board, they favor this brokerage fee?

Secretary REGAN. The S. & L.'s actually wanted this brokerage service and the Federal Home Loan Bank Board staff had no objection.

Senator PROXMIRE. They did support it?

Secretary REGAN. They did support it.

Senator PROXMIRE. Well, I wonder if they still would. I doubt it, from what I've heard. But anyway, let me ask one other question because I think this is really the fundamental problem we have here. The thrifts are very important to all of us, of course, and we want to do all we can to preserve them. I think they are very important institutions, certainly in all of our States. At the same time, the reason for the thrifts is to support housing, and I wonder if this legislation that is before us today wouldn't, in effect, just walk away from that special function that thrifts have performed very well over the last many years and create a situation in which home buyers and homebuilders just wouldn't have a financial institution which would provide the kind of service that thrifts have in the past at the price they have in the past with the expertise they have in the past.

SACRIFICE TAX ADVANTAGES

Secretary REGAN. Well, at the risk of being repetitious, Senator, I am convinced that they would not immediately turn away from the housing industry and get into those other powers. Look at what they would do if they were to do that. First of all, they would sacrifice many of their tax advantages. You know the tax situation of thrifts as well as I do, so I won't bother to review that but the more they get into other asset powers, the less tax advantage they would have.

Second, most of the people within the thrift industry—management and the like—are primarily concerned with the housing industry. I don't think they are going to turn their backs on the industry immediately and walk away from it. At the same time, we are encouraging commercial banks to come back into the housing market which they have abandoned over the past few years. I think the combination will give as much money to the housing industry as it could possibly want, when the price of money gets to where the housing industry can use it.

Frankly what's wrong with the housing industry at this point is price, the price of money. It is too high to make profits in building houses, but as soon as we can get interest rates down, then I think the housing industry—

Senator PROXMIRE. Well, of course, you're absolutely right. The fundamental problem is the interest rates right now. But I am just afraid when that problem is gone, that we will have lost much of the great advantage to housing that savings and loans provided. I was disturbed—you are an extraordinarily articulate and intelligent man, I think one of the ablest people in the administration without any question, but you said immediately turn away—you wouldn't expect them to immediately turn away and immediately abandon the expertise they have in housing. The implication was

that they would turn away eventually but not immediately. That is not a very happy future for a housing industry.

Secretary REGAN. I will withdraw the adverb. I would put it this way—I don't think they will turn their backs on the industry. I think that the major activities of the thrift industry will still be in the housing area. Look what we're doing for them, allowing them to go into real estate. A great many of the savings and loan association people have told me that if they could take a piece of the action, this would encourage them to go into it even more. I think that since we are giving them that power in S. 1720 it will encourage them to stay in the industry. So I don't think you need to fear that, Senator.

Senator PROXMIRE. Well, I hope you're right.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, I would just interject at this point, in response to Senator Proxmire's question, this is the Banking, Housing and Urban Affairs Committee, and so we do have great concern for housing. But what I see taking place, Mr. Chairman, and I share some of your fears of making these changes, but unless we do, I see no S. & L. industry left, literally. And I think the alternative is we have got to try some other means or there isn't going to be housing money available because the thrifts are not going to be in the business anymore.

On the other hand, I think what the Secretary said is true, that housing demand is so tremendous, there is no lack of people who want to buy houses. It is their inability to qualify for loans in order to purchase those houses. If the interest rates come down, I don't think we will be able to build houses rapidly enough. I think the industry will be there to respond if they are still healthy. If we can keep them healthy in the meantime, they are going to respond to that demand. I think we have got to proceed with some of these restructuring changes to make them competitive for the future and get those interest rates down, and then that demand for housing is going to be overwhelming, in my opinion.

Senator Schmitt?

Senator SCHMITT. Thank you, Mr. Chairman.

Mr. Secretary, it's good to be with you today and listen to you with a great deal of interest, and I hope that I'm getting educated at the same time. I've always found, as Senator Garn knows, that the Banking Committee may be the most educational committee that I sit upon, probably because I know the least about the subject. But I am concerned, Mr. Secretary, that as we attempt to level the playing field through deregulation, which I fully support, that we are building mountains on that playing field by other actions that are outside the jurisdiction of this committee for the most part.

For example, if the all savers certificate does represent not only an allocation of credit but also the use of the Tax Code to establish certain interest rates, and in another area which I have expressed my concern before this committee just recently, loan guarantees, we further allocate credit—one measure just was approved by the Congress by not vetoing it just the other day, and that is the TOSCO loan guarantee for \$1.125 billion. I'm sorry I couldn't find a

way to force the Senate to vote on that. I couldn't. Nevertheless, it is a major allocation of credit and it is one of many.

CAPPING LOAN GUARANTEES

I understand that the question of loan guarantees, that the administration hopes to cap loan guarantees. Could you expand on that a little bit, to see if this one mountain may not grow any higher than it has in the past?

Secretary REGAN. Well, like you, Senator, we in the administration are concerned about the use of Government guarantees. We think that Government guarantees need to be cut back and cut back sharply, because they put certain agencies in competition, not only with Treasury but with private borrowing, for the amount of credit that is available. We think that if there is a justifiable economic reason, these agencies should be able to go ahead on their own without a Government guarantee to get the money. If there isn't any justifiable reason for the funds, then what's the sense of putting a Government guarantee behind the security. We are working with the Office of Management and Budget to see which of these guarantees we can cap, eliminate, or cut back sharply. And I think that, within a matter of weeks, you will be seeing the results of our efforts.

Senator SCHMITT. Could we expect to see the synfuels loan guarantees reevaluated in that operation?

Secretary REGAN. We are taking a very careful look at that, yes, sir.

Senator SCHMITT. Do you recall the level of credit allocations for loan guarantees that occurred in fiscal 1981?

Secretary REGAN. It is about \$48 billion net new guarantees. It's going to be about the same in 1982, unless we cap it.

Senator SCHMITT. Do you recall the level of credit allocation that has occurred through low-interest loans in fiscal 1981?

Secretary REGAN. We can get you that number for the record. [The following information was received from the Treasury Department:]

Direct loans made at below market interest rates equaled over \$64 billion in fiscal 1981 and the subsidy involved was over \$16 billion.

Senator SCHMITT. But it is in the \$50 billion range?

Secretary REGAN. Yes, it is. There is quite a subsidy in there.

Senator SCHMITT. And again, without congressional action, that presumably would continue in fiscal 1982.

Secretary REGAN. Yes, but that's another area that Treasury and OMB are working on to cut back as much as possible. It is a very sensitive area, politically, as you know.

Senator SCHMITT. There's no question. But it does, does it not impact the issues that we're talking about today, and that is, what are the capabilities of the thrift institutions to provide capital for other purposes?

Secretary REGAN. Oh, yes. Because there is only a certain pool of funds within the United States that is available for capital allocation. I recall some figures, Senator, that might be of interest to you. It used to be that the Federal Government took 16 to 20 percent of all the credit in the United States. Currently, the Feder-

al Government is taking 36 percent, and if you throw in State and local governments, it is well over 40 percent, probably closer to 45 percent of every credit dollar now is going to the Federal Government or to a Federal agency. We think that is much too high and not sustainable.

Senator SCHMITT. Doesn't credit allocation of this kind have the same effect in terms of pressure on interest rates that financing the deficit has?

Secretary REGAN. Well, I'm not sure that it's the same pressure, but at least there is pressure there. There is no doubt about it that the more credit that the Federal Government takes, the less there is available to others which means the money rates stay high.

Senator SCHMITT. What's the difference between a loan guarantee of \$1 billion in terms of pressure on interest rates and the Federal Government financing a \$1 billion deficit.

Secretary REGAN. It would be approximately the same, the only question would be the difference in interest rates between the Federal-guaranteed loan and the actual Federal borrowing.

Senator SCHMITT. Now on the other side of that, of this problem of other things outside the jurisdiction of this committee that we do to build mountains on the playing field, the all savers certificates is an allocation of credit. It again may have been necessary for a short period of time, but wouldn't we be far better off in terms of leveling the playing field, if we just built in incentives for savings and investment across the board, rather than trying to exercise our wisdom on what is the best way to allocate credit?

Secretary REGAN. I would agree with you, Senator, I would much rather let the marketplace do it and do it through the Tax Code for everybody. That is why I was in favor of the new IRA/Keogh provisions of the Tax Code. That way you allow people a tax break for savings for their old age, for retirement, and at the same time let them choose the instrument rather than let the Government say which instrument would be better than another.

Senator SCHMITT. So if we really want to level the playing field, we should be looking at least in three directions, one is, as in S. 1720, to try to equalize the rules by which the game is played between various types of institutions. Second, to build in strong incentives across the board for savings and investment, whatever instrument may be chosen, depending upon the individual's needs and desires. And third, to try to get the Government out of the marketplace, out of borrowing from that pool of capital or causing to be borrowed from the pool of capital that the various institutions have to use for whatever places the marketplace otherwise would dictate.

Secretary REGAN. I'm not sure S. 1720 should carry all of those provisions.

Senator SCHMITT. No, I'm not saying that it can, but we can't think of S. 1720 in a vacuum. We could write a beautiful deregulation bill, say, comparable to the Telecommunications Act, which is making the law transparent to changes in technology and changes in the marketplace. But if we don't also recognize that that could pale into insignificance, because we allocate credit through the Tax Code or we allocate credit through loan guarantees, then we have

failed. And we might as well not have gone through the effort to create the bill.

Secretary REGAN. That is correct, Senator. I think the setting for S. 1720 has to be within that type of philosophy.

Senator SCHMITT. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Dixon, we appreciate your patience and no one could understand it better than I. For those in this group who don't realize why I can understand it so well, Senator Dixon and Senator Dodd are the only two new Democrats in the whole class of 1980. Senator Paul Laxalt and I were the only two new Republicans in 1974. Therefore, he and I understand better than anybody else what it is to sit on the last row. The only difference, I was on the other corner. So I do sympathize with your position and appreciate your patience.

I would like to turn to you for questions now.

Senator DIXON. Thank you, Mr. Chairman.

Mr. Secretary, I join others on the committee who are pleased by your decision of the half percent increase on the passbook accounts. I don't know that I was able to ascertain from questions previously asked as to whether there is any chance that you will reassess your position on deregulating interest rates on IRA and Keogh accounts, which Senator Proxmire addressed to some extent in his questions.

Secretary REGAN. I would not see any reason to revisit that issue at this time. I think we have done the right thing on the IRA and Keogh accounts. I think we should stick with our position on that.

MASSIVE MERGERS AND TAKEOVERS

Senator DIXON. Mr. Secretary, I come from a State with many hundreds of commercial banks and savings and loan association. Many are saying that S. 1703 and S. 1720 will lead to massive mergers into and takeovers by large bank holding companies. If you don't think this will happen, can you tell me why it won't?

Secretary REGAN. Well, at the present time, S. 1720 only authorizes interstate and interindustry mergers for troubled institutions. It does not authorize a healthy institution's takeover on an interstate or an interindustry basis. In my opening remarks, I encouraged greater intrastate and intraindustry type of branch banking, so that institutions could get ready if interstate banking is permitted in the future.

I might elaborate a little bit on that, Senator. I've heard the same type of argument before, you're going to ruin the little man or the smaller institution. We heard the same thing on Wall Street when we said we were going to go from partnerships to corporations, that we would wipe out the small partnership. It never happened.

It was said that if we went to competitive rates, in Wall Street that a few large brokerage firms would end up with all of the available resources, there would be no room for the small brokerage firm. It hasn't happened.

The point of fact is, there are more members today on the New York Exchange than when we deregulated commissions. I heard the same thing about the airline industry, that if you deregulated the airline industry, you would wipe out the smaller ones.

Well, at least initially, deregulation seems to be helping the small commuter airlines. And the larger ones seem to be in difficulty.

Now, I think that if we eventually deregulate more than we are now, that the small bank is still going to know its customers. It is going to provide services that a big bank can never provide, the friendliness, the day-to-day contact, that type of thing. So I'm not one who thinks that you will suddenly find Bank of America in Prairie View, or you will find Continental Illinois in Bellevue. I don't think that type of thing is going to happen.

Senator DIXON. It's Bellevue, Mr. Secretary, but you're close. There is a Bellevue in Illinois, as well.

Secretary REGAN. But from my point of view, I think that you're going to find more and more that these big institutions, if they are allowed, will go toward money centers rather than to small towns.

Senator DIXON. Thank you, Mr. Secretary.

It is a fact, is it not, that all of this legislation really doesn't address one of the central questions that everyone is concerned about, and that is the fact that conventional mortgages just aren't being written around the country anymore? Do you see anything in this legislation at all that addresses that problem?

Secretary REGAN. Well, we are helping the thrift industry to stay alive, so it can get back into the marketplace at such time as mortgages are once again somewhere below 14 percentage, I think that is when mortgages will be written.

Senator DIXON. Yes, and that's the point I was getting to. Until interest rates get down, we're just not going to be able to solve the problem of the conventional mortgage in this kind of legislation, in your view; is that true?

Secretary REGAN. No, you won't. It is a question of the cost of money at this point.

Senator DIXON. Wouldn't you think that an extension of the all savers certificate for a longer period of time would encourage at least more thrift institutions to consider—

Secretary REGAN. No, I don't.

Senator DIXON. You think that's a bad idea?

Secretary REGAN. I think that the all savers certificate is a temporary solution to a terrible problem. But I think it has to be a temporary solution; it is not a long-range solution. It enables the thrifts to have earning power at a time when they are most desperate for earning power. I think as soon as interest rates come down, and thrifts go back to their traditional mortgage investment augmented by the new investment powers in S. 1720, that thrifts can go back to getting their liabilities the same way that they have always gotten them, through competition in the open marketplace.

Senator DIXON. One final question. At the expense of being repetitious, because I really think that you addressed this to some extent twice already during the course of your period of time answering questions here, but many of the folks are saying that this legislation really will do harm to the housing industry, in that it will reduce the investment in the housing market by thrifts and other things, and actually in the final analysis reduce the amount of money available for the housing industry. I take it from the answers you've given to previous questions, that you think that

these additional powers in these institutions will, in fact, ultimately expand money for the housing industry; is that basically your position?

S. 1720 IS LONG-RANGE SOLUTION

Secretary REGAN. Yes, it is, Senator, S. 1720 provides for both temporary and long-range solutions to the problems of the thrift industry. It keeps the industry alive, so that thrifts can get back into competition and get more funds into their respective institutions and enables them to loan that money out again at a profit. They will be making mortgages again when mortgages are at rates people are willing to pay—when interest rates are lower.

So I think that S. 1720 will help the housing industry. If you don't pass this bill, what is the alternative for the housing industry? What if we have no thrift industry at all? If we had none at all, what would the housing industry do?

You have to have a viable thrift industry, and in order to have a viable thrift industry, you have to start with S. 1720.

Senator DIXON. Thank you, Mr. Secretary.

The CHAIRMAN. Mr. Secretary, as we have seen interest rates go up rather dramatically in the past few years, I think most people realize and Congress realizes that we need to provide regulators with emergency powers. Unfortunately, that is about all that they're talking about in the House of Representatives. It seems to me that that is very shortsighted. Congress normally responds in that way with moratoriums, with extensions, with prohibitions, with emergency type legislation. To only do that, as the House of Representatives proposes, seems to me to not look at the real problem.

They are really reluctant to look at expanding thrifts' powers and their ability to do business. Don't you think it is at least equally as important that we provide thrifts with the ability to protect their savings and their earnings, as to provide their regulators with additional powers. If all we do is provide the regulators with additional powers with the business cycles going up and down, all we've done is say government is the answer rather than the marketplace.

Would you agree that we must address the assets side and give the thrifts additional flexibility to operate? Not just in the current circumstances but maybe even more important because of the time it would take for them to be able to absorb these new expanded powers?

We are really trying to look at the future in this legislation.

Secretary REGAN. Well, I think that what you are trying to do is to save an industry rather than just rescue it and still have it floundering. I think that if all you do is provide temporary solutions, the industry itself cannot plan its future. I think with S. 1720 in place, the industry can draw a deep breath to see where it's going to go. I've always believed in long-range planning, particularly for financial institutions.

As we said at the outset, Mr. Chairman, the financial industry is in a changing mode. It has been for the last few years. It is going to change even more over the next few years. To the extent that you do not allow the thrift industry to change with changing times,

you do it a disservice, and it is going to be left in the wake. I think that unless you expand the asset powers, unless you authorize additional earnings potential, you are not going to have that thrift industry in place. To the extent that the thrift industry is just being rescued from possible defaults, that isn't the answer for the housing industry. You want a strong industry in place, when we emerge from our current economic condition.

And I think you have done wisely in structuring S. 1720 to accommodate that.

The CHAIRMAN. Well, it would appear to me that if we don't do more than just the so-called bare bones regulators bill, as it is referred to, we will simply make it necessary in the future for having even more government assistance.

Now, I would love to put things back the way they used to be with thrifts doing their thing and commercial banks doing their thing, and Merrill Lynch doing their thing, and not tampering with bank-type activities.

Secretary REGAN. I wouldn't want that. [Laughter.]

The CHAIRMAN. But I think you've made the point very adequately, that that isn't the real world, and the thrift industry is in trouble today for one reason and one reason only, because of their specialized function, which we all applaud. But they have been borrowing short and lending long; 25-30 year mortgages at 6, 7, 8 and 9 percent. And that is why we are in trouble. If we don't try to address that problem, I don't see any future for the thrift industry and the housing market.

I'm getting back to what Senator Proxmire said. I don't know that anybody knows where that dividing line should be, but I think we end up losing an entire industry, unless we do give them the ability to compete in a market that is dramatically different than what we have ever seen before.

That leads me into recent testimony of the Independent Bankers Association before the House Banking Committee. They testified in opposition to a fundamental restructuring of our Nation's financial industry. "It would benefit only a few large banks and other financial conglomerates."

Now I certainly would not be sponsoring this legislation. I don't know how many times I've been quoted, especially since I became chairman of the committee, that I did not want to see the financial structure of this country controlled by 12 or 15 large banks. I certainly would not be proposing any legislation that I thought would do that, but I would appreciate your comments on who you think would benefit. Is this only for Chase and the biggies, or do you feel it would help the small people as well?

Secretary REGAN. I think it will help both, Mr. Chairman. I don't think that this passage of S. 1720 will be the ruination of the independent, small bank. I think that the independent small bank is being helped by this legislation. There are additional things here again on the asset side that they can do. As I suggested in my testimony, if banks structure themselves similarly to thrift institutions, we would like to see that they get the same tax break as thrift institutions do. We are making it easier for them to get into other financial instruments such as money market funds which, I think is the type of thing that we have to do for the small banks.

But I think as long as they continue to provide that excellent service and the personalized service that they have provided so successfully in the past, they don't need to worry about the banking system of the United States ending up in the hands of any 15 or 20 large corporations.

THREAT FROM NONBANKING-TYPE INSTITUTIONS

The CHAIRMAN. Well, it seems to me that the competition is not within the traditional depository institutions anyway. The real threat to their traditional dominance in these fields is the new nonbanking-type of institutions. That is what puzzles me. I don't think there is anyone who could be more sympathetic with the independent bankers problems than I.

But to sit back and say we don't want any restructuring with Sears out there with hundreds of stores, the biggest retailer in the world, getting involved in the financial services industry with no restrictions whatsoever. No State boundaries, no county boundaries or anything else, no one to report to, the way that the small independent bankers do, and say that we're afraid of the big traditional financial institutions, I think that is where I have a problem with understanding their opposition to considering restructuring. It seems to me that competition is much more dangerous to their existence as small independent institutions, from nonbanking institutions that are essentially getting into the banking business without the restrictions that they abide by. Not worrying about the Chases and the Citicorps and the like.

Would you agree that the \$150 billion of money market funds and all of these new type of mergers in nonbanking-type institutions is a bigger threat to little institutions than their own types of institutions that they have traditionally competed with?

Secretary REGAN. I would say so, because again, many of their customers are beginning to realize what is going on in the marketplace because of high interest rates which are brought on by inflation. And each person is trying in his own way to protect himself against inflation. Now to the extent that they're not allowed to compete with these other nonbanking corporations, they are going to be at a disadvantage.

I would much rather see us try to enable them to compete, than try to regulate the others to keep them out of competition. I don't think that's the way the Federal Government should go.

I further recall that in S. 1720 we are trying to help them with the amount of loans they can make vis-a-vis their capital. There are many things in that bill that are designed to help them, and I think it will.

So from my point of view, I don't think they have to worry about the effects of S. 1720.

The CHAIRMAN. Senator Schmitt.

Senator SCHMITT. Thank you, Mr. Chairman.

I suspect that the Secretary has another place or two to be today. And I would just ask him one question before I conclude, and that is that we haven't heard any mention of credit unions within the context of S. 1720. Do you care to comment on that?

Secretary
there regard

It seems to me that there are provisions in
tral liquidity fund that will be helpful to

the credit unions. I think that they are satisfied with the bill. We are certainly in favor of the few provisions that there are in S. 1720 regarding them.

I think they are in a fairly healthy condition, they are competitive, and they will be able to compete very effectively with some of the provisions that are in this bill.

Senator SCHMITT. Well, some of our small bankers might say that they compete more than effectively, because of their favorable tax treatment. Do you see that tax situation as becoming anticompetitive, as interest rates come down and the thrift institutions become more competitive across the board with the money market funds?

Secretary REGAN. At this particular moment, Senator, their tax advantage over banks is really not that great. Most banks' effective tax rates are fairly low, because of other features of the tax code that have been designed to help them. We will keep an eye on it—but I don't think there is any real cause for concern at this moment.

Senator SCHMITT. Well, thank you, Mr. Secretary, and again, I just would emphasize the importance of this committee keeping its eye on the tax code, because we have been doing things with the tax code through the years that have significantly affected the competition within the thrift industry itself and within financial institutions overall.

And I hope that we will try to deal with those tax provisions in the context of everything else we must do, and not just by themselves.

Mr. Chairman, I think the Secretary once again has shown us his grasp of these subjects. And it's been great to have a dialogue with him today.

The CHAIRMAN. Senator Dixon, do you have any further questions?

Senator DIXON. Just two, Mr. Chairman.

First, let me also express my appreciation to you, Mr. Secretary, for your help here this morning. At the expense of being a devil's advocate, notwithstanding everything we are doing here, some would say that there are still a great many regulations and rules governing financial institutions, and on the other hand, there are not such rules and regulations governing money market funds, and that as a consequence of all of this it is still not an even playing field, et cetera, et cetera. I wonder if you could respond to that position taken by many in the financial institutions.

MONEY MARKET FUND ADVANTAGES

Secretary REGAN. Well, I think that money market funds have had an advantage, for a very apparent reason: They are answering a consumer need in a period of time when the consumer is looking for an antidote to inflation. Now we are deregulating depository institutions and allowing them to compete. Under S. 1720, for example, banks will be able to offer, underwrite and manage money market funds if they so choose. There are many other things they would be able to do under S. 1720 that heretofore they have not been able to do.

Now, it is true that so far we at Treasury at least would not advocate allowing thrift institutions to underwrite money market

funds. We are saying they have enough new powers coming on with S. 1720; let them get experience in these first, and then we will change. In other words, a two-step approach to the thrifts; a one-step as far as Glass-Steagall is concerned, with the commercial banks. I am one who believes in deregulation, not only because it is the Administration's policy, but because I am a competitor, and I think the less the Government impedes competition, the better off the actual players are.

I would therefore much rather see us deregulate others to compete with the money market funds than to try to regulate money market funds in order to slow them down to make the competition more equal.

Senator DIXON. Thank you. Now, finally, I am sure you are aware—as we all are—that you can get as many opinions from the Congress as you can from lawyers. And we have all read the many different comments about the modest drop in interest rates recently. Some say that interest rates will moderate further. Some say it is a short, cyclical matter, and that interest rates will go even higher toward the end of the year. So I know it is entirely speculative. But is there any light at the end of the tunnel?

Secretary REGAN. There is a light. And it is not an oncoming train. [Laughter.]

I think that the interest rates have peaked, Senator, and I think that although they never come down in a straight line that interest rates will be lower at the end of the year than they are currently. And I think the reason, of course, is that inflation is coming down. If you look at all the signs—industrial production is off, automobile sales are off, retail sales are barely keeping even with inflation, leading indicators are down—I think the whole thing points to the fact that we are in a flat period. The President called it yesterday a recession. He said a light one; I agree. I think that in this type of period you naturally expect interest rates to come down, and I think that is what we will see.

Now, to the extent that we keep a slow, steady monetary growth, we will pull out of this recession, without too much damage, and as that happens, I hope we have the thrift industries ready to do what it has done so successfully in the past, and that is to help the housing industry.

Senator DIXON. Thank you, Mr. Secretary.

The CHAIRMAN. Mr. Secretary, there are a large number of additional questions here, but as I get to the bottom of the stack they become more and more technical. Your time is valuable. So what I would like to do is submit additional questions to you for response in writing. And I am sure some of the other members who could not be here this morning would like to do that as well.

[The answers to the following questions from Senator D'Amato were received in time for the publication of this volume. Answers to further questions of Secretary Regan will be printed in part II of this hearing record:]

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Senator D'Amato's questions regarding
Secretary Regan's October 19th Testimony
before
The Senate Banking Committee

QUESTION 1:

In today's prepared testimony with regard to "Expanded Powers for Thrift Institutions," you attribute a major portion of the thrift industry's problems to the imbalance between increasingly rate sensitive liabilities and long-term relatively rate insensitive assets.

Under your chairmanship the DIDC has established a new 4 week averaging formula for the rate on a six month money market certificate at an estimated cost to savings and loans of \$300 million. The DIDC has totally removed interest rate ceilings on IRA and Keogh Accounts effective December 1, a move which many fear will precipitate a rate war of dangerous proportions. And finally among other things, the DIDC increased the passbook ceiling by 50 basis points at an estimated cost to savings and loans of \$500 million, with you yourself questioning the wisdom of such an increase less than one month later.

Mr. Secretary, would you tell the committee what strategy the DIDC is going to adopt to improve the imbalance between asset yield and liabilities which is currently plaguing our thrift industry?

ANSWER:

The DIDC's strategy to improve the imbalance between asset and liability yields has two major thrusts. The first includes supporting the expanded asset and liability powers for thrift institutions that are proposed in S.1720. The expanded asset powers should enable thrifts to invest some of their deposits more profitably in higher yielding, shorter-term consumer and commercial loans. The second is the DIDC's decision to deregulate interest rate ceilings primarily by starting with time deposits with longer-term maturities. This action should help thrifts attract longer-term deposits to better match the maturities of their mortgage assets.

The DIDC's deregulation strategy has been implemented by several recent actions:

(1) As you mentioned, the DIDC has authorized the creation of a new market rate deposit instrument available only when placed in an individual retirement account (IRA) or Keogh plan. These retirement savings are generally longer-term, stable funds. The DIDC hopes that by allowing depository institutions to pay market rates for these funds that the institutions will be able to compete with other market rate investment alternatives for the large increase in retirement savings that should (as a result of the Tax Act of 1981) become available on January 1, 1982. We believe that "a rate war of dangerous proportions" will not result from this action. Well managed institutions will offer market interest rates that they can invest at a profit, offering higher rates would not be necessary or prudent.

(2) The Committee has published for public comment a proposed schedule for progressively deregulating time deposits starting with a new three and one half year and over deposit category. This new time deposit category would have no Federally set interest rate ceiling and other characteristics that would make it attractive to depositors. The Committee has received repeated requests from depository institutions for a systematic method of phasing out rate ceilings in order for the institutions to plan their business in advance.

(3) The Committee also voted to allow, but not require, depository institutions to change their MMC rate calculations to pay the higher of the current average auction rate on

26-week T-bills plus 25 basis points or a 4-week moving average of past auction rates on 26-week T-bills. Thus, when Treasury interest rates are declining faster than the rates paid by money market funds (MMFs), depository institutions will be able to compete for and retain maturing MMCs instead of seeing them withdrawn and deposited in higher yielding MMFs or other market rate instruments. Depository Institutions requested this competitive feature and the DIDC has given them the option to use or not use it as they see fit. When Treasury bill rates are declining, this alternative rate could increase the cost of MMCs for those institutions who offer the higher rate, however, the cost of the MMCs would be less than the cost of replacing the MMCs with money borrowed from the FHLBB or from commercial banks. When Treasury bill rates are rising faster than other market rates, some depository institutions might choose to lower their costs on MMCs by offering the lower average auction rate.

(4) The Committee also voted to increase the ceilings on the passbook savings slightly. Congress in the Depository Institutions Deregulation and Monetary Control Act of 1980 required the DIDC to consider increasing the ceiling on passbook accounts no later than 18 months after passage of the bill. The Congressional mandate, the flood of letters from savers, the Federal subsidy that depository institutions will receive in the form of the All Savers Certificates (ASC) and the belief that increasing the passbook ceilings might help to stem the outflow of passbook savings (which

reached an annual rate of \$54 billion in the first 8 months of 1981) were all factors that convinced three members of the DIDC to vote for an increase in the passbook ceiling rate.

Subsequent to this action, I have been told by thrift institution executives that consumers are shifting funds from their passbook accounts to the ASCs. They have indicated that the shifting of deposits is increasing the industry's earnings problems. Since there is no official information (ASCs were first offered October 1), I decided that it would be prudent to delay the passbook ceiling increase until we can determine what impact ASCs are having on thrift earnings.

QUESTION 2:

As Secretary of the Treasury, I am sure you find yourself in a predicament between loss to the Treasury and deregulation of the savings industry. Could you give this committee any information on the present revenue losses to the Treasury and what is your timetable for reversing this loss should your recommendations be adopted?

ANSWER:

The thrift industry's effective tax rate, due to their bad debt allowance, is about 27.6 percent. Since the industry is expected to have a loss this year, Treasury's revenue from this industry will no doubt be below that of last year when the industry's aggregate earnings were slightly positive. However, the amount of Treasury's revenue loss can not be estimated until we have some information on the impact the All Savers Certificates are having on industry earnings.

The industry is experiencing large losses at this time because the cost of money is more than the industry is able

Well, at least initially, deregulation seems to be helping the small commuter airlines. And the larger ones seem to be in difficulty.

Now, I think that if we eventually deregulate more than we are now, that the small bank is still going to know its customers. It is going to provide services that a big bank can never provide, the friendliness, the day-to-day contact, that type of thing. So I'm not one who thinks that you will suddenly find Bank of America in Prairie View, or you will find Continental Illinois in Bellevue. I don't think that type of thing is going to happen.

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Senator DIXON. Thank you, Mr. Secretary.

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Secretary REGAN. Well, we are helping the thrift industry to stay alive, so it can get back into the marketplace at such time as mortgages are once again somewhere below 14 percentage, I think that is when mortgages will be written.

Senator DIXON. Yes, and that's the point I was getting to. Until interest rates get down, we're just not going to be able to solve the problem of the conventional mortgage in this kind of legislation, in your view; is that true?

Secretary REGAN. No, you won't. It is a question of the cost of money at this point.

Senator DIXON. Wouldn't you think that an extension of the all savers certificate for a longer period of time would encourage at least more thrift institutions to consider—

Secretary REGAN. No, I don't.

Senator DIXON. You think that's a bad idea?

Secretary REGAN. I think that the all savers certificate is a temporary solution to a terrible problem. But I think it has to be a temporary solution; it is not a long-range solution. It enables the thrifts to have earning power at a time when they are most desperate for earning power. I think as soon as interest rates come down, and thrifts go back to their traditional mortgage investment augmented by the new investment powers in S. 1720, that thrifts can go back to getting their liabilities the same way that they have always gotten them, through competition in the open marketplace.

Senator DIXON. One final question. At the expense of being repetitious, because I really think that you addressed this to some extent twice already during the course of your period of time answering questions here, but many of the folks are saying that this legislation really will do harm to the housing industry, in that it will reduce the investment in the housing market by thrifts and other things, and actually in the final analysis reduce the amount of money available for the housing industry. I take it from the answers you've given to previous questions, that you think that

these additional powers in these institutions will, in fact, ultimately expand money for the housing industry; is that basically your position?

S. 1720 IS LONG-RANGE SOLUTION

Secretary REGAN. Yes, it is, Senator, S. 1720 provides for both temporary and long-range solutions to the problems of the thrift industry. It keeps the industry alive, so that thrifts can get back into competition and get more funds into their respective institutions and enables them to loan that money out again at a profit. They will be making mortgages again when mortgages are at rates people are willing to pay—when interest rates are lower.

So I think that S. 1720 will help the housing industry. If you don't pass this bill, what is the alternative for the housing industry? What if we have no thrift industry at all? If we had none at all, what would the housing industry do?

You have to have a viable thrift industry, and in order to have a viable thrift industry, you have to start with S. 1720.

Senator DIXON. Thank you, Mr. Secretary.

The CHAIRMAN. Mr. Secretary, as we have seen interest rates go up rather dramatically in the past few years, I think most people realize and Congress realizes that we need to provide regulators with emergency powers. Unfortunately, that is about all that they're talking about in the House of Representatives. It seems to me that that is very shortsighted. Congress normally responds in that way with moratoriums, with extensions, with prohibitions, with emergency type legislation. To only do that, as the House of Representatives proposes, seems to me to not look at the real problem.

They are really reluctant to look at expanding thrifts' powers and their ability to do business. Don't you think it is at least equally as important that we provide thrifts with the ability to protect their savings and their earnings, as to provide their regulators with additional powers. If all we do is provide the regulators with additional powers with the business cycles going up and down, all we've done is say government is the answer rather than the marketplace.

Would you agree that we must address the assets side and give the thrifts additional flexibility to operate? Not just in the current circumstances but maybe even more important because of the time it would take for them to be able to absorb these new expanded powers?

We are really trying to look at the future in this legislation.

Secretary REGAN. Well, I think that what you are trying to do is to save an industry rather than just rescue it and still have it floundering. I think that if all you do is provide temporary solutions, the industry itself cannot plan its future. I think with S. 1720 in place, the industry can draw a deep breath to see where it's going to go. I've always believed in long-range planning, particularly for financial institutions.

As we said at the outset, Mr. Chairman, the financial industry is in a changing mode. It has been for the last few years. It is going to change even more over the next few years. To the extent that you do not allow the thrift industry to change with changing times,

you do it a disservice, and it is going to be left in the wake. I think that unless you expand the asset powers, unless you authorize additional earnings potential, you are not going to have that thrift industry in place. To the extent that the thrift industry is just being rescued from possible defaults, that isn't the answer for the housing industry. You want a strong industry in place, when we emerge from our current economic condition.

And I think you have done wisely in structuring S. 1720 to accommodate that.

The CHAIRMAN. Well, it would appear to me that if we don't do more than just the so-called bare bones regulators bill, as it is referred to, we will simply make it necessary in the future for having even more government assistance.

Now, I would love to put things back the way they used to be with thrifts doing their thing and commercial banks doing their thing, and Merrill Lynch doing their thing, and not tampering with bank-type activities.

Secretary REGAN. I wouldn't want that. [Laughter.]

The CHAIRMAN. But I think you've made the point very adequately, that that isn't the real world, and the thrift industry is in trouble today for one reason and one reason only, because of their specialized function, which we all applaud. But they have been borrowing short and lending long; 25-30 year mortgages at 6, 7, 8 and 9 percent. And that is why we are in trouble. If we don't try to address that problem, I don't see any future for the thrift industry and the housing market.

I'm getting back to what Senator Proxmire said. I don't know that anybody knows where that dividing line should be, but I think we end up losing an entire industry, unless we do give them the ability to compete in a market that is dramatically different than what we have ever seen before.

That leads me into recent testimony of the Independent Bankers Association before the House Banking Committee. They testified in opposition to a fundamental restructuring of our Nation's financial industry. "It would benefit only a few large banks and other financial conglomerates."

Now I certainly would not be sponsoring this legislation. I don't know how many times I've been quoted, especially since I became chairman of the committee, that I did not want to see the financial structure of this country controlled by 12 or 15 large banks. I certainly would not be proposing any legislation that I thought would do that, but I would appreciate your comments on who you think would benefit. Is this only for Chase and the biggies, or do you feel it would help the small people as well?

Secretary REGAN. I think it will help both, Mr. Chairman. I don't think that this passage of S. 1720 will be the ruination of the independent, small bank. I think that the independent small bank is being helped by this legislation. There are additional things here again on the asset side that they can do. As I suggested in my testimony, if banks structure themselves similarly to thrift institutions, we would like to see that they get the same tax break as thrift institutions do. We are making it easier for them to get into other financial instruments such as money market funds which, I think is the type of thing that we have to do for the small banks.

But I think as long as they continue to provide that excellent service and the personalized service that they have provided so successfully in the past, they don't need to worry about the banking system of the United States ending up in the hands of any 15 or 20 large corporations.

THREAT FROM NONBANKING-TYPE INSTITUTIONS

The CHAIRMAN. Well, it seems to me that the competition is not within the traditional depository institutions anyway. The real threat to their traditional dominance in these fields is the new nonbanking-type of institutions. That is what puzzles me. I don't think there is anyone who could be more sympathetic with the independent bankers problems than I.

But to sit back and say we don't want any restructuring with Sears out there with hundreds of stores, the biggest retailer in the world, getting involved in the financial services industry with no restrictions whatsoever. No State boundaries, no county boundaries or anything else, no one to report to, the way that the small independent bankers do, and say that we're afraid of the big traditional financial institutions, I think that is where I have a problem with understanding their opposition to considering restructuring. It seems to me that competition is much more dangerous to their existence as small independent institutions, from nonbanking institutions that are essentially getting into the banking business without the restrictions that they abide by. Not worrying about the Chases and the Citicorps and the like.

Would you agree that the \$150 billion of money market funds and all of these new type of mergers in nonbanking-type institutions is a bigger threat to little institutions than their own types of institutions that they have traditionally competed with?

Secretary REGAN. I would say so, because again, many of their customers are beginning to realize what is going on in the marketplace because of high interest rates which are brought on by inflation. And each person is trying in his own way to protect himself against inflation. Now to the extent that they're not allowed to compete with these other nonbanking corporations, they are going to be at a disadvantage.

I would much rather see us try to enable them to compete, than try to regulate the others to keep them out of competition. I don't think that's the way the Federal Government should go.

I further recall that in S. 1720 we are trying to help them with the amount of loans they can make vis-a-vis their capital. There are many things in that bill that are designed to help them, and I think it will.

So from my point of view, I don't think they have to worry about the effects of S. 1720.

The CHAIRMAN. Senator Schmitt.

Senator SCHMITT. Thank you, Mr. Chairman.

I suspect that the Secretary has another place or two to be today. And I would just ask him one question before I conclude, and that is that we haven't heard any mention of credit unions within the context of S. 1720. Do you care to comment on that?

Secretary REGAN. It seems to me that there are provisions in there regarding the central liquidity fund that will be helpful to

the credit unions. I think that they are satisfied with the bill. We are certainly in favor of the few provisions that there are in S. 1720 regarding them.

I think they are in a fairly healthy condition, they are competitive, and they will be able to compete very effectively with some of the provisions that are in this bill.

Senator SCHMITT. Well, some of our small bankers might say that they compete more than effectively, because of their favorable tax treatment. Do you see that tax situation as becoming anticompetitive, as interest rates come down and the thrift institutions become more competitive across the board with the money market funds?

Secretary REGAN. At this particular moment, Senator, their tax advantage over banks is really not that great. Most banks' effective tax rates are fairly low, because of other features of the tax code that have been designed to help them. We will keep an eye on it—but I don't think there is any real cause for concern at this moment.

Senator SCHMITT. Well, thank you, Mr. Secretary, and again, I just would emphasize the importance of this committee keeping its eye on the tax code, because we have been doing things with the tax code through the years that have significantly affected the competition within the thrift industry itself and within financial institutions overall.

And I hope that we will try to deal with those tax provisions in the context of everything else we must do, and not just by themselves.

Mr. Chairman, I think the Secretary once again has shown us his grasp of these subjects. And it's been great to have a dialogue with him today.

The CHAIRMAN. Senator Dixon, do you have any further questions?

Senator DIXON. Just two, Mr. Chairman.

First, let me also express my appreciation to you, Mr. Secretary, for your help here this morning. At the expense of being a devil's advocate, notwithstanding everything we are doing here, some would say that there are still a great many regulations and rules governing financial institutions, and on the other hand, there are not such rules and regulations governing money market funds, and that as a consequence of all of this it is still not an even playing field, et cetera, et cetera. I wonder if you could respond to that position taken by many in the financial institutions.

MONEY MARKET FUND ADVANTAGES

Secretary REGAN. Well, I think that money market funds have had an advantage, for a very apparent reason: They are answering a consumer need in a period of time when the consumer is looking for an antidote to inflation. Now we are deregulating depository institutions and allowing them to compete. Under S. 1720, for example, banks will be able to offer, underwrite and manage money market funds if they so choose. There are many other things they would be able to do under S. 1720 that heretofore they have not been able to do.

Now, it is true that so far we at Treasury at least would not advocate allowing thrift institutions to underwrite money market

funds. We are saying they have enough new powers coming on with S. 1720; let them get experience in these first, and then we will change. In other words, a two-step approach to the thrifts; a one-step as far as Glass-Steagall is concerned, with the commercial banks. I am one who believes in deregulation, not only because it is the Administration's policy, but because I am a competitor, and I think the less the Government impedes competition, the better off the actual players are.

I would therefore much rather see us deregulate others to compete with the money market funds than to try to regulate money market funds in order to slow them down to make the competition more equal.

Senator DIXON. Thank you. Now, finally, I am sure you are aware—as we all are—that you can get as many opinions from the Congress as you can from lawyers. And we have all read the many different comments about the modest drop in interest rates recently. Some say that interest rates will moderate further. Some say it is a short, cyclical matter, and that interest rates will go even higher toward the end of the year. So I know it is entirely speculative. But is there any light at the end of the tunnel?

Secretary REGAN. There is a light. And it is not an oncoming train. [Laughter.]

I think that the interest rates have peaked, Senator, and I think that although they never come down in a straight line that interest rates will be lower at the end of the year than they are currently. And I think the reason, of course, is that inflation is coming down. If you look at all the signs—industrial production is off, automobile sales are off, retail sales are barely keeping even with inflation, leading indicators are down—I think the whole thing points to the fact that we are in a flat period. The President called it yesterday a recession. He said a light one; I agree. I think that in this type of period you naturally expect interest rates to come down, and I think that is what we will see.

Now, to the extent that we keep a slow, steady monetary growth, we will pull out of this recession, without too much damage, and as that happens, I hope we have the thrift industries ready to do what it has done so successfully in the past, and that is to help the housing industry.

Senator DIXON. Thank you, Mr. Secretary.

The CHAIRMAN. Mr. Secretary, there are a large number of additional questions here, but as I get to the bottom of the stack they become more and more technical. Your time is valuable. So what I would like to do is submit additional questions to you for response in writing. And I am sure some of the other members who could not be here this morning would like to do that as well.

[The answers to the following questions from Senator D'Amato were received in time for the publication of this volume. Answers to further questions of Secretary Regan will be printed in part II of this hearing record:]

Senator D'Amato's questions regarding
Secretary Regan's October 19th Testimony
before
The Senate Banking Committee

QUESTION 1:

In today's prepared testimony with regard to "Expanded Powers for Thrift Institutions," you attribute a major portion of the thrift industry's problems to the imbalance between increasingly rate sensitive liabilities and long-term relatively rate insensitive assets.

Under your chairmanship the DIDC has established a new 4 week averaging formula for the rate on a six month money market certificate at an estimated cost to savings and loans of \$300 million. The DIDC has totally removed interest rate ceilings on IRA and Keogh Accounts effective December 1, a move which many fear will precipitate a rate war of dangerous proportions. And finally among other things, the DIDC increased the passbook ceiling by 50 basis points at an estimated cost to savings and loans of \$500 million, with you yourself questioning the wisdom of such an increase less than one month later.

Mr. Secretary, would you tell the committee what strategy the DIDC is going to adopt to improve the imbalance between asset yield and liabilities which is currently plaguing our thrift industry?

ANSWER:

The DIDC's strategy to improve the imbalance between asset and liability yields has two major thrusts. The first includes supporting the expanded asset and liability powers for thrift institutions that are proposed in S.1720. The expanded asset powers should enable thrifts to invest some of their deposits more profitably in higher yielding, shorter-term consumer and commercial loans. The second is the DIDC's decision to deregulate interest rate ceilings primarily by starting with time deposits with longer-term maturities. This action should help thrifts attract longer-term deposits to better match the maturities of their mortgage assets.

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The DIDC's deregulation strategy has been implemented by several recent actions:

(1) As you mentioned, the DIDC has authorized the creation of a new market rate deposit instrument available only when placed in an individual retirement account (IRA) or Keogh plan. These retirement savings are generally longer-term, stable funds. The DIDC hopes that by allowing depository institutions to pay market rates for these funds that the institutions will be able to compete with other market rate investment alternatives for the large increase in retirement savings that should (as a result of the Tax Act of 1981) become available on January 1, 1982. We believe that "a rate war of dangerous proportions" will not result from this action. Well managed institutions will offer market interest rates that they can invest at a profit, offering higher rates would not be necessary or prudent.

(2) The Committee has published for public comment a proposed schedule for progressively deregulating time deposits starting with a new three and one half year and over deposit category. This new time deposit category would have no Federally set interest rate ceiling and other characteristics that would make it attractive to depositors. The Committee has received repeated requests from depository institutions for a systematic method of phasing out rate ceilings in order for the institutions to plan their business in advance.

(3) The Committee also voted to allow, but not require, depository institutions to change their MMC rate calculations to pay the higher of the current average auction rate on

26-week T-bills plus 25 basis points or a 4-week moving average of past auction rates on 26-week T-bills. Thus, when Treasury interest rates are declining faster than the rates paid by money market funds (MMFs), depository institutions will be able to compete for and retain maturing MMCs instead of seeing them withdrawn and deposited in higher yielding MMFs or other market rate instruments. Depository Institutions requested this competitive feature and the DIDC has given them the option to use or not use it as they see fit. When Treasury bill rates are declining, this alternative rate could increase the cost of MMCs for those institutions who offer the higher rate, however, the cost of the MMCs would be less than the cost of replacing the MMCs with money borrowed from the FHLBB or from commercial banks. When Treasury bill rates are rising faster than other market rates, some depository institutions might choose to lower their costs on MMCs by offering the lower average auction rate.

(4) The Committee also voted to increase the ceilings on the passbook savings slightly. Congress in the Depository Institutions Deregulation and Monetary Control Act of 1980 required the DIDC to consider increasing the ceiling on passbook accounts no later than 18 months after passage of the bill. The Congressional mandate, the flood of letters from savers, the Federal subsidy that depository institutions will receive in the form of the All Savers Certificates (ASC) and the belief that increasing the passbook ceilings might help to stem the outflow of passbook savings (which

reached an annual rate of \$54 billion in the first 8 months of 1981) were all factors that convinced three members of the DIDC to vote for an increase in the passbook ceiling rate.

Subsequent to this action, I have been told by thrift institution executives that consumers are shifting funds from their passbook accounts to the ASCs. They have indicated that the shifting of deposits is increasing the industry's earnings problems. Since there is no official information (ASCs were first offered October 1), I decided that it would be prudent to delay the passbook ceiling increase until we can determine what impact ASCs are having on thrift earnings.

QUESTION 2:

As Secretary of the Treasury, I am sure you find yourself in a predicament between loss to the Treasury and deregulation of the savings industry. Could you give this committee any information on the present revenue losses to the Treasury and what is your timetable for reversing this loss should your recommendations be adopted?

ANSWER:

The thrift industry's effective tax rate, due to their bad debt allowance, is about 27.6 percent. Since the industry is expected to have a loss this year, Treasury's revenue from this industry will no doubt be below that of last year when the industry's aggregate earnings were slightly positive. However, the amount of Treasury's revenue loss can not be estimated until we have some information on the impact the All Savers Certificates are having on industry earnings.

The industry is experiencing large losses at this time because the cost of money is more than the industry is able

to earn on its old and new mortgage assets. However, when interest rates fall the earnings that result from assets made during the current high interest rate period should reverse the revenue loss Treasury will experience this year.

Question 3:

Mr. Secretary, I am intrigued by your proposal that banks be authorized to expand their securities activities only if they conduct these activities through a bank holding company subsidiary. As you noted in your testimony, this limitation may eliminate some of the competitive advantages banks might otherwise enjoy, and would enable us to approach the goal of "equal regulation" in a more meaningful way.

Of course, whether this Committee proceeds along the lines of your proposal or the approach taken in S. 1720, we will be making major inroads into the policies underlying the Glass-Steagall Act. As you know, the Act took the drastic step of separating commercial and investment banking, largely because it was believed that the promotional incentives and economic interest which the bank would have in the securities activity was destructive of prudent and disinterested banking, as well as of public confidence in the banking system.

I am very concerned about whether these dangers may still exist, as well as any additional risks that such conflicts of interest may pose for investors. It is not clear to me that the securities laws, which were enacted on the assumption that banks would not generally engage in securities activities, by themselves could protect against these hazards.

Would you please share with us your thoughts on whether any of the policies underlying the Glass-Steagall Act have relevance today, and how the implementation of your proposal could guard against the type of unsound practices which led to the passage of that statute?

Answer:

In proposing that banks participate in traditional securities activities through a subsidiary of a bank holding company, we are seeking to address a number of issues which go significantly beyond the historical focus of permitting banks

to underwrite revenue bonds and more recently to allow bank sponsorship and underwriting of mutual fund shares.

Rather than deal with the concerns associated with these two securities activities on a piecemeal basis, the bank holding company subsidiary concept provides a vehicle in which the broader spectrum of securities activities could be conducted over the long run. Moreover, the bank holding company vehicle, by serving as a means of separating the Federally insured depository business of banking from activities that may have a higher degree of risk, paves the way for new depository activities such as making direct investments in real estate.

The Treasury Department is generally satisfied that public confidence in the nation's financial system has been adequately supported by the Federal deposit insurance program and the establishment of a comprehensive and successful framework of banking and securities laws, regulations and examinations. Apprehensions surrounding the potential for conflicts of interest, however, are likely to grow as banks expand into new activities and our proposed bank holding company vehicle would provide additional safeguards by strengthening the arms length relationship between commercial and investment banking relationships. In addition, the subsidiary concept will eliminate certain competitive advantages afforded banks under the existing statutes, namely: preferential tax treatment in the carrying of securities in inventory; financing based on the cost of bank's insured deposits; and

regulation by Federal bank regulatory agencies for whom securities activities are only a limited aspect of bank business.

As the liberalization of Glass-Steagall proceeds, however, the Treasury Department will remain attentive to proposals which would enhance existing safeguards without unduly increasing restrictions which could offset the procompetitive aspects of such legislation.

The CHAIRMAN. Certainly your appearance here today is not the end of our working together to try and fashion this legislation over the weeks ahead. So I want to thank you very much for your testimony here today. We do have one additional witness, Congressman Dorgan of North Dakota. But the committee will stand in recess until 11 o'clock, for about 17 minutes. Thank you very much.

[Recess.]

The CHAIRMAN. The committee will come to order. We are happy to have with us Congressman Dorgan of North Dakota.

Congressman, we are pleased to have you here, and we would be happy to hear from you at this time.

STATEMENT OF BYRON DORGAN, REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH DAKOTA

Mr. DORGAN. Mr. Chairman, thank you very much. I appreciate the willingness of the committee to hear my testimony. I know that your discussion this morning concerns savings and loan institutions, and I would like with your permission to provide just a few remarks on a more general basis with respect to the current talk about banking deregulation, both in the U.S. Senate and the U.S. House. I am concerned about this issue from the standpoint of the service we receive from banking and thrift institutions in North Dakota.

It is my feeling that the thrift institutions are suffering these days from a monetary policy that has driven interest rates to record highs and has caused some rather dramatic problems for the savings and loan industry. I don't think, however, that we can solve those problems that are caused by current monetary policy, by deregulating the financial institutions, in the manner that has been discussed both in the House and the Senate.

PROHIBITION AGAINST BRANCH BANKING

States like North Dakota have traditionally decided that they want a certain type of financial institution to serve them. We have prohibitions against branch banking, as do many States. We have decided that we do not want certain eastern multibank holding companies or banking institutions to come in and purchase North Dakota banks, and end up with four or five banking institutions. We do not want our banking decisions made in boardrooms that

are, in many cases, 1,000 or 2,000 or 3,000 miles away from North Dakota. Having made those judgments in our State, we do not now want to see the dismantling of several decades of banking laws in the name of deregulation.

My view, in short, is that rural areas of America such as North Dakota are best served by networks of independent financial institutions, and that we need to create economic conditions in which those networks of institutions thrive. Local ownership and management of those institutions serve our States very well, and has for many decades.

I am not one who is against progress just because progress represents change, but I don't think that we, in a time of financial turmoil in this country, in most cases caused by tight money and high interest rates, should move precipitously in an area of regulation which has developed over many years to our benefit. The specific bill that you are discussing today, as I mentioned, does deal with savings and loans. And my concern is that the Secretary of the Treasury and many others in Congress would lead us to believe that deregulation of all thrift and banking institutions somehow serves the best interests of the American consumer. I think there is substantial evidence in the country that shows that the opposite is true.

I want to encourage your committee to move very carefully and very, very slowly, on the issue of deregulation regarding this and subsequent legislation. And that, in very brief, is my statement, Mr. Chairman.

REVOLUTION TAKING PLACE

The CHAIRMAN. Congressman, I appreciate your testimony. I would say, however, in response, to your advice that we use caution—most of the issues that are encompassed in this bill were being discussed before I became a member of this committee 7 years ago. They are not new issues that arise out of current monetary policy or current problems of the thrift institutions.

In 1975 we passed the Financial Institutions Act in the Senate. It was not passed by the House. Over and over again this committee has considered these items. The matter of municipal revenue bonds has passed the Senate before.

So I wanted to make sure you understood that, that we are hardly proceeding precipitously. These issues have been around for a long, long time, even before this Senator came to the Senate.

Second, I would say that the comments you just gave are almost exact duplicates of what I said many times as a new Senator several years ago, as a member of this committee. But I think that we have to face where the real competition is coming from. I made the comments again in the hearing this morning, I wish we could go back to some prior day where we had S. & L.'s doing their thing, and commercial banks doing theirs, and securities people minding their own business.

But we simply are seeing a revolution taking place. The Independent Bankers undoubtedly tomorrow will testify against change. I don't think there is any doubt about that. I think we have to take stock of where the competition is coming from; \$150 billion in money market funds, and going up. Even after the inter-

est rates come down I do not see these new types of instruments changing.

American Express buying Shearson; Prudential buying Bache; and so on. To caution us to be very careful about deregulation is good advice, but if we do not proceed with some equity and fairness, then these small, independent institutions are going to lose their businesses, but not the Chase Manhattans and the big ones who want to have unlimited interstate branching—and this bill certainly does not address that.

It only addresses interstate branching in troubled institutions. After all, intrastate has been explored. We don't want to have any panic or run on the financial institutions. And so the part that addresses interstate branching is very limited and very narrowly defined.

I think Congress cannot sit back and see this revolution take place without trying to address these problems, to consider them carefully. You look at the example of Sears, the world's largest retailer, that now owns a very large savings and loan and a full-service securities. They have no prohibitions as to geographical areas whatsoever. They will be able to come in and offer all kinds of services through their stores, in North Dakota, and Utah. Utah is also a rural State with small financial institutions.

But I think we cannot wish for something in the past with this new competition of nonfinancial institutions engaging in financial services, and in banking services that traditionally have been proscribed by these rules and regulations.

I think it is important that the Congress address those problems and start taking a look at them—carefully, as you say—but recognizing that we have an entirely different ball game now. New competitors who don't have to play by the same rules that the small banks and S. & L.'s in your State and in mine have to play by. And I worry about that competition, and I think—I make no bones about it—I think it is incredibly unfair.

I have said over and over again until people are tired of hearing it in this committee that I don't like what the securities industry is doing. At least if they would be honest about it, and sit at that table and say, "Yes, we are at least getting in on the fringes of the banking business," but they sit there in my hearings, and say, "Oh, no; no, we're not. We are not at all. You just keep Glass-Steagall and McFadden, keep everybody all tied up, while we go about our business. Don't put any rules and regulations on us."

So again, I appreciate your testimony and your suggestion that we proceed carefully. We will. But "carefully," I hope, is a matter of weeks in the case of some of these things, and months in the case of the larger issues, and not the years we have been struggling with of these issues.

Mr. DORGAN. Well, Senator, I appreciate your comments, and agree with most of them. My concern is that the leadership coming from the Secretary of the Treasury and some others would move us more quickly than I think we should move, and in directions in which I think we should not move, with respect to financial institutions.

I am not suggesting that we should wish for what was yesterday. But I do think that there are some who wish for a tomorrow that I

don't want to see in North Dakota, and that I think you would not want to see in Utah, with respect to financial institutions that now serve Utah and North Dakota.

And I am concerned that the present problems that face the savings and loan industry have been created by the tight money policy of the Federal Reserve Board, yet will allow dramatic changes in financial institutions to take place much more quickly than otherwise would be possible. I see that movement over in the House of Representatives, and I am concerned about it in Congress generally.

The CHAIRMAN. I would only make one other comment. Don't place all the blame on the monetary policy of the Federal Reserve. The problems of high interest rates are far beyond their discount rate and their managing the money supply. I don't really care who the Chairman of the Federal Reserve Board is; Congress over the years has created our trillion dollar debt and continues to add to it each year.

And the major driving force, in my opinion, is fiscal policy. I am not a monetarist. I sat here all these years listening to the testimony, and I hear about fine tuning. I think the economists are kidding themselves. Liberal, conservative, Democrat and Republican economists as well have testified on that particular position, and most of them have been wrong. And they talk about it like they can fine tune it to the tenth of a percent. And they are kidding themselves. They are living in a dream world.

So the point I wanted to make is that even if you had interest rates go down tomorrow, for whatever reason—Congress suddenly gets their act together, the Fed has as much power as some people seem to think they have, and you had single-digit inflation rates—it would not change my mind one bit on the need for looking at these problems. I think we are very shortsighted if we do not address them. And this again is not something that is being looked at only as a result of the current high interest rates. It has been going on for a long time, because those markets have been changing prior to getting involved in these very high interest rates.

DEREGULATION HAS TO BE THE ANSWER

So I hope when the interest rates come down that we do not stop trying to look at how we ought to restructure, because again, I would agree with you, I don't want a few big banks controlling North Dakota, but I also don't want Sears, American Express, and Shearson. Right now that small independent banker is caught in between, and I think it is our responsibility in the Congress to try and protect those small people. I don't think it will happen by maintaining the status quo at all. And I think deregulation in whatever extent has to be the answer.

Mr. DORGAN. Well, I respect your assessment. But it is my judgment that the monetary policy has created tremendous problems for financial institutions, and we don't share the same view with respect to the power of the Federal Reserve Board. I revere the memory of old Wright Patman, who tried desperately for decades to change it. And I think we ought to change the structure of the Federal Reserve Board.

I do think that the Fed's tight money policy has created artificial high interest rates, at least six real points above the rate of inflation, with the economic rent above that. I think this Fed policy has caused real distortions in the competitive position of financial institutions, and has put the savings and loan institutions in particular in a very precarious position. And I am worried that a lot of folks would use that and other economic conditions to force changes in the banking structure that would have little chance of passage at this point were that not the case.

The CHAIRMAN. Well, we generally agree, but we do disagree on that point. I think the bodies we both serve are the major culprits, and that is where the major restructuring ought to occur if we want to solve the problem.

I appreciate your testimony and your willingness to come today. Thank you very much.

Mr. DORGAN. Thank you.

The CHAIRMAN. The committee will be adjourned until 9:30 a.m. tomorrow. The witnesses tomorrow will be representatives of the American Bankers Association and the Independent Bankers Association of America. Wednesday the hearings will also be at 9:30 a.m., and we will hear the U.S. Savings and Loan League, the National Savings and Loan League, the National Association of Mutual Savings Banks, the National Association of Realtors, the Mortgage Bankers Association, the National Association of Home Builders. On Thursday, to complete the hearings of this week, also

9:30 a.m.—the first panel will be the Investment Company Institute and the American Council of Life Insurers; the second panel is the Securities Industry Association, the Dealer Bankers Association, and the Independent Insurance Agents of America; and a third panel will be the National League of Cities, the National Association of Counties, the U.S. Conference of Mayors, the National Governors Association.

The committee is adjourned.

[Whereupon, at 11:10 a.m., the hearing was adjourned.]

[Copies of the bills referred to at this hearing follow:]

97TH CONGRESS
1ST SESSION

S. 1686

To amend the Federal Reserve Act to provide that deposits of State and local overnments will not be subject to reserve requirements, and for other purposes.

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 30 (legislative day, SEPTEMBER 9), 1981

Mr. LUGAR introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To amend the Federal Reserve Act to provide that deposits of State and local governments will not be subject to reserve requirements, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 That (a) section 19(b)(6) of the Federal Reserve Act (12
4 U.S.C. 461(b)(6)) is amended—

5 (1) by inserting “(A)” before “The requirements”;
6 and

7 (2) by adding at the end thereof the following:

1 “(B) The requirements imposed under paragraph (2)
2 shall not apply to demand deposits of public funds by—

3 “(i) an officer, employee, or agent of the United
4 States;

5 “(ii) an officer, employee, or agent of any State of
6 the United States, or of any county, municipality, or
7 political subdivision thereof;

8 “(iii) an officer, employee, or agent of the District
9 of Columbia; or

10 “(iv) an officer, employee, or agent of the Com-
11 monwealth of Puerto Rico, of the Virgin Islands, of
12 American Samoa, of Guam, of any territory or posses-
13 sion of the United States, or of any county, municipal-
14 ity, or political subdivision thereof;

15 having official custody of such funds and lawfully investing or
16 depositing the same.”.

17 (b) Section 204 of the Depository Institutions Deregula-
18 tion and Monetary Control Act of 1980 (12 U.S.C. 3503) is
19 amended by adding at the end thereof the following:

20 “(c) Notwithstanding any other provision of this title,
21 the Deregulation Committee shall increase the limitation on
22 the maximum rate of interest which may be paid on any cate-
23 gory of deposits referred to in section 19(b)(6)(B) of the Fed-
24 eral Reserve Act so that the maximum rate applicable to all

1 such categories of deposits is the same or is determined in the
2 same manner.”.

3 (c) Section 2(a)(2) of Public Law 93-100 (12 U.S.C.
4 1832(a)(2)) is amended by inserting before the period at the
5 end thereof the following: “; and with respect to deposits of
6 public funds by an officer, employee, or agent of the United
7 States, any State, county, municipality, or political subdivi-
8 sion thereof, the District of Columbia, the Commonwealth of
9 Puerto Rico, American Samoa, Guam, any territory or pos-
10 session of the United States, or any political subdivision
11 thereof”.



97TH CONGRESS
1ST SESSION

S. 1703

To enhance the competitiveness of thrift institutions, to protect depositors and creditors of such institutions, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 5 (legislative day, SEPTEMBER 9), 1981

Mr. GARN (by request) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To enhance the competitiveness of thrift institutions, to protect depositors and creditors of such institutions, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 TITLE I—FORM OF CHARTER: DEMAND

4 ACCOUNTS

5 SEC. 101. This Act may be cited as the “Thrift Institu-
6 tions Restructuring Act of 1981”.

7 SEC. 102. Section 5(a) of the Home Owners’ Loan Act
8 of 1933 (12 U.S.C. 1464(a)) is amended to read as follows:

1 “(a) In order to provide thrift institutions for the deposit
2 or investment of funds and for the extension of credit for
3 homes and other goods and services, the Board is authorized,
4 under such rules and regulations as it may prescribe, to pro-
5 vide for the organization, incorporation, examination, oper-
6 ation, and regulation of associations to be known as Federal
7 Savings and Loan Associations, or Federal Savings Banks,
8 and to issue charters therefor, giving primary consideration
9 to the best practices of thrift institutions in the United
10 States.”.

11 SEC. 103. Section 5(b) (1) and (2) of the Home Owners’
12 Loan Act of 1933 (12 U.S.C. 1464(b) (1) and (2)) are amend-
13 ed to read as follows:

14 “(b)(1) An association may raise capital in the form of
15 such savings deposits, shares, or other accounts, for fixed,
16 minimum, or indefinite periods of time (all of which are re-
17 ferred to in this section as savings accounts), or in the form of
18 such demand accounts, as are authorized by its charter or by
19 regulations of the Board, and may issue such passbooks, time
20 certificates of deposit, or other evidence of accounts as are so
21 authorized. All savings accounts and demand accounts shall
22 have the same priority upon liquidation. Holders of accounts
23 and obligors of an association shall, to such extent as may be
24 provided by its charter or by regulations of the Board, be
25 members of the association, and shall have such voting rights

1 and such other rights as are thereby provided. Except as may
2 be otherwise authorized by the association's charter or regu-
3 lation of the Board in the case of savings accounts for fixed
4 or minimum terms of not less than fourteen days, the pay-
5 ment of any savings account shall be subject to the right of
6 the association to require such advance notice, not less than
7 fourteen days, as shall be provided for by the charter of the
8 association or the regulations of the Board. The payment of
9 withdrawals from accounts in the event an association does
10 not pay all withdrawals in full (subject to the right of the
11 association, where applicable, to require notice) shall be sub-
12 ject to such rules and procedures as may be prescribed by the
13 association's charter or by regulation of the Board, but any
14 association which, except as authorized in writing by the
15 Board, fails to make full payment of any withdrawal when
16 due shall be deemed to be in an unsafe or unsound condition
17 to transact business within the meaning of subsection (d) of
18 this section. Accounts may be subject to check or to with-
19 drawal or transfer on negotiable or transferable or other
20 order or authorization to the association, as the Board may
21 by regulation provide. Notwithstanding any limitations of this
22 section, associations may establish remote service units for
23 the purpose of crediting savings or demand accounts, debiting
24 such accounts, crediting payments on loans, and the disposi-

1 tion of related financial transactions, as provided in regula-
2 tions prescribed by the Board.

3 “(2) To such extent as the Board may authorize by reg-
4 ulation or advise in writing, an association may borrow, may
5 give security, may be surety as defined by the Board and
6 may issue such notes, bonds, debentures, or other obligations,
7 or other securities, including capital stock, as the Board may
8 so authorize.”.

9 SEC. 104. Section 5(i) of the Home Owners' Loan Act
10 of 1933 (12 U.S.C. 1464(i)) is amended to read as follows:

11 “(i)(1) Any institution that is, or is eligible to become, a
12 member of a Federal Home Loan Bank may convert itself
13 into a Federal Savings and Loan Association or Federal Sav-
14 ings Bank under this Act (and in so doing may change direct-
15 ly from the mutual form to the stock form, or the reverse),
16 but such conversion shall be subject to such rules and regula-
17 tions as the Board shall prescribe, and thereafter the convert-
18 ed association shall be entitled to all the benefits of this sec-
19 tion and shall be subject to examination and regulation to the
20 same extent as other associations incorporated pursuant this
21 Act.

22 “(2) Subject to the rules and regulations of the Board,
23 any Federal association may convert itself from the mutual
24 form to the stock form of organization, or from the stock form
25 to the mutual form, and any Federal association may change

1 its designation from a Federal Savings and Loan Association
2 to a Federal Savings Bank, or the reverse.

3 “(3) Any Federal association may convert itself into a
4 savings and loan or savings bank type of institution organized
5 pursuant to the laws of the State, district, commonwealth, or
6 territory (hereinafter referred to in this section as the
7 “State”) in which the principal office of such Federal associ-
8 ation is located: *Provided*, That (i) the State permits the con-
9 version of any savings and loan or savings bank type of insti-
10 tution of such State into a Federal association; (ii) that such
11 conversion of a Federal association into such a State institu-
12 tion is determined upon the vote in favor of such conversion
13 cast in person or by proxy at a special meeting of members or
14 stockholders called to consider such action, specified by the
15 law of the State in which the home office of the Federal
16 association is located, as required by such law for a State-
17 chartered institution to convert itself into a Federal associ-
18 ation, but in no event upon a vote of less than 51 per centum
19 of all the votes cast at such meeting, and upon compliance
20 with other requirements reciprocally equivalent to the re-
21 quirements of such State law for the conversion of a State-
22 chartered institution into a Federal association; (iii) that
23 notice of the meeting to vote on conversion shall be given as
24 herein provided and no other notice thereof shall be neces-
25 sary; the notice shall expressly state that such meeting is

1 called to vote thereon, as well as the time and place thereof,
2 and such notice shall be mailed, postage prepaid, at least
3 thirty and not more than sixty days prior to the date of the
4 meeting, to each member or stockholder of record of the Fed-
5 eral association at his last address as shown on the books of
6 the Federal association and to the General Counsel of the
7 Federal Home Loan Bank Board, Washington, District of
8 Columbia; (iv) that, in the event of dissolution of a mutual
9 association after conversion, the members or shareholders of
10 the association will share on a mutual basis in the assets of
11 the association in exact proportion to their relative share or
12 account credits; (v) that, in the event of dissolution of a stock
13 association after conversion, the stockholders will share on
14 an equitable basis in the assets of the association; and (vi)
15 that such conversion shall be effective upon the date that all
16 the provisions of this Act shall have been fully complied with
17 and upon the issuance of a new charter by the State wherein
18 the association is located; it being provided that its act of
19 converting into a State-chartered institution shall constitute
20 an agreement to be bound by all the requirements that the
21 Federal Savings and Loan Insurance Corporation may legal-
22 ly impose under section 403 of title IV of the National Hous-
23 ing Act, as now or hereafter amended, and the association
24 shall upon conversion and thereafter be authorized to issue
25 securities in any form currently approved at the time of issue

1 by the Federal Savings and Loan Insurance Corporation for
2 issuance by similar insured institutions in such State: *Pro-*
3 *vided*, That if the insurance of accounts is terminated in con-
4 nection with such conversion, the notice and other action
5 shall be taken as provided by law and regulations for the
6 termination of insurance of accounts.

7 “(4) Any aggrieved person may obtain review of a final
8 action of the Board or the Federal Savings and Loan Insur-
9 ance Corporation which approves, with or without conditions,
10 or disapproves a plan of conversion from the mutual to the
11 stock form, only by complying with the provisions of subsec-
12 tion (k) of section 408 of the National Housing Act within the
13 time limit and in the manner therein prescribed, which provi-
14 sions shall apply in all respects as if such final action were an
15 order the review of which is therein provided for, except that
16 such time limit shall commence upon publication of notice of
17 such final action in the Federal Register or upon the giving of
18 such general notice of final action as is required by or ap-
19 proved under regulations of the Corporation, whichever is
20 later.

21 “(5) To the extent authorized by the Board, (i) any Fed-
22 eral savings bank chartered as such prior to the enactment of
23 this paragraph may continue to make any investment or
24 engage in any activity not otherwise authorized under this
25 section, to the degree it was permitted to do so as a Federal

1 savings bank prior to such enactment, and (ii) any Federal
2 savings bank formerly organized as a mutual savings bank
3 under State law may continue to make any investment or
4 engage in any activity not otherwise authorized under this
5 section, to the degree it was authorized to do so as a mutual
6 savings bank under State law. The authority conferred by
7 this paragraph may be utilized by any Federal association
8 that acquires, by merger or consolidation, a Federal savings
9 bank enjoying grandfathered rights hereunder.”.

10 SEC. 105. Section 402(j) of the National Housing Act
11 (12 U.S.C. 1725(j)) is amended as follows:

12 (a) By amending paragraph (1) to read as follows:

13 “(1) Other than as provided in section 5 of the Home
14 Owners’ Loan Act of 1933, as amended, no insured institu-
15 tion may convert from the mutual to the stock form except in
16 accordance with the rules and regulations of the Corpora-
17 tion.”;

18 (b) By striking paragraphs (2), (3), (5), and (6),
19 and renumbering paragraph (4) as paragraph (2).

20 SEC. 106. Section 2(d) of the Home Owners’ Loan Act
21 of 1933 (12 U.S.C. 1462(d)) is amended by striking the word
22 “mutual” wherever it appears.

23 SEC. 107. Section 403(a) of the National Housing Act
24 (12 U.S.C. 1726(a)) is amended by striking the word
25 “mutual”.

1 **Sec. 219.** Section 415(a)(2) of the National Housing
2 Act of 1938 (12 U.S.C. 1720(a)(2)) is amended to read as fol-
3 lows:

4 "(A) 'insured institution' means a Federal savings
5 and loan association, a Federal savings bank, or a
6 building and loan, savings and loan, or insured as-
7 sociation, or a cooperative bank, the accounts of which
8 are insured by the Federal Savings and Loan Insur-
9 ance Corporation."

10 TITLE II—INVESTMENTS

11 **Sec. 201.** Section 5(a)(1)(A) of the Home Owners' Loan
12 Act of 1933 (12 U.S.C. 1464(a)(1)(A)) is amended to read as
13 follows:

14 "(A) ACCOUNT LOANS.—Loans on the security of
15 its savings accounts and loans specifically related to
16 transactions accounts."

17 **Sec. 202.** Section 5(c)(1)(B) of the Home Owners' Loan
18 Act of 1933 (12 U.S.C. 1464(c)(1)(B)) is amended to read as
19 follows:

20 "(B) REAL PROPERTY LOANS.—Loans on the se-
21 curity of liens upon residential or nonresidential real
22 property."

23 **Sec. 203.** Section 5(c)(1)(G) of the Home Owners' Loan
24 Act of 1933 (12 U.S.C. 1464(c)(1)(G)) is amended to read as
25 follows:

1 “(G) DEPOSITS.—Investments in the time depos-
2 its, certificates, or accounts of any bank the deposits of
3 which are insured by the Federal Deposit Insurance
4 Corporation, or in the savings accounts, certificates or
5 other accounts of any institution the accounts of which
6 are insured by the Federal Savings and Loan Insur-
7 ance Corporation.”.

8 SEC. 204. Section 5(c)(1)(H) of the Home Owners’ Loan
9 Act of 1933 (12 U.S.C. 1464(c)(1)(H)) is amended to read as
10 follows:

11 “(H) STATE SECURITIES.—Investments in obli-
12 gations of, or issued by, any State or political subdivi-
13 sion thereof (including any agency, corporation or in-
14 strumentality).”.

15 SEC. 205. Section 5(c)(1) of the Home Owners’ Loan
16 Act (12 U.S.C. 1464(c)(1)) is amended by striking subpara-
17 graph (L) and adding a new subparagraph (L), to read as
18 follows:

19 “(L) COMMERCIAL AND OTHER LOANS.—Secured
20 or unsecured loans for commercial, corporate, business
21 or agricultural purposes. No association may make
22 loans to one borrower under the authority provided by
23 this subparagraph in excess of the amount a national
24 bank having an identical total capital and surplus could
25 lend such borrower.”.

1 SEC. 206. Section 5(c)(1)(O) of the Home Owner's Loan
2 Act of 1933 (12 U.S.C. 1464(c)(1)(O)) is amended to read as
3 follows:

4 “(O) HOUSING AND LAND AND URBAN DEVELOP-
5 MENT INSURED OR GUARANTEED INVESTMENTS.—(i)
6 Loans secured by mortgages as to which the associ-
7 ation has the benefit of insurance under title X of the
8 National Housing Act or of a commitment or agree-
9 ment for such insurance, or (ii) loans as to which the
10 association has the benefit of any guarantee under title
11 IV of the Housing and Urban Development Act of
12 1968 or under part B of the National Urban Policy
13 and New Community Development Act of 1970 or
14 under section 802 of the Housing and Community De-
15 velopment Act of 1974 as now or hereafter in effect,
16 or of a commitment or agreement therefor.”.

17 SEC. 207. Section 5(c)(1) of the Home Owners' Loan
18 Act of 1933 (12 U.S.C. 1464(c)(1)) is amended by striking
19 subparagraph (P) and adding a new subparagraph (P), to read
20 as follows:

21 “(P) CORPORATE SECURITIES.—An association
22 may invest in, sell or hold commercial paper and cor-
23 porate debt securities, as defined and approved by the
24 Board. No association may make investments under
25 the authority provided by this subparagraph in the

1 paper or securities of one obligor or maker in excess of
2 the amount a national bank having identical total capi-
3 tal and surplus could so invest in the paper or securi-
4 ties of one obligor or maker.”.

5 SEC. 208. Section 5(c)(1)(Q) of the Home Owners’ Loan
6 Act of 1933 (12 U.S.C. 1464(c)(1)(Q)) is amended to read as
7 follows:

8 “(Q) INVESTMENT COMPANIES.—An association
9 may invest in, redeem or hold shares or certificates in
10 any open-end management investment company which
11 is registered with the Securities and Exchange Com-
12 mission under the Investment Company Act of 1940
13 and the portfolio of which is restricted by such man-
14 agement company’s investment policy, changeable only
15 if authorized by shareholder vote, primarily to such in-
16 vestments (without regard to any percentage-of-assets
17 restriction applicable to such investment under this
18 subsection) as an association by law or regulation may
19 invest in, sell, redeem, hold, or otherwise deal with.”.

20 SEC. 209. Section 5(c)(1) of the Home Owners’ Loan
21 Act of 1933 (12 U.S.C. 1464(c)(1)) is amended by adding a
22 new subparagraph (R), to read as follows:

23 “(R) CONSUMER LOANS.—An association may
24 make secured or unsecured loans for personal, family

1 or household purposes, and loans reasonably incident to
2 the provision of such credit.”.

3 SEC. 210. Section 5(c) of the Home Owners’ Loan Act
4 of 1933 (12 U.S.C. 1464(c)) is amended by:

5 (a) Striking paragraph (2);

6 (b) Redesignating paragraph (6) as paragraph (5);

7 (c) Adding new paragraph (2), to read as follows:

8 “(2) INVESTMENTS IN PERSONALTY.—An associ-
9 ation may invest in tangible personal property, includ-
10 ing, without limitation, vehicles, mobile homes, ma-
11 chinery, equipment, or furniture, and may hold such
12 property for rental or sale, but such investment is lim-
13 ited to not in excess of 10 per centum of the assets of
14 the association.”;

15 (d) Amending paragraph (3) as follows:

16 (1) By striking subparagraph (D); and

17 (2) By amending subparagraph (A) to read as fol-
18 lows:

19 “(A) EDUCATION LOANS.—Loans made for the
20 payment of educational expenses.”, and

21 (e) Amending paragraph (4) as follows:

22 (1) By amending subparagraph (B) to read as fol-
23 lows:

24 “(B) SERVICE CORPORATIONS.—Investments in
25 the capital stock, obligations, or other securities of any

1 corporation organized under the laws of the State in
2 which the home office of the association is located, if
3 the entire capital stock of such corporation is available
4 for purchase only by savings and loan associations of
5 that State and by Federal associations having their
6 home offices therein, but no association may make any
7 investment under this subparagraph if its aggregate
8 outstanding investment under this subparagraph would
9 exceed 5 per centum of the assets of the association:
10 *Provided, That an association may make an investment*
11 *under this subparagraph notwithstanding that the serv-*
12 *ice corporation in which investment is authorized has*
13 *invested in any other corporation (i) that is not char-*
14 *tered by the State in which the home office of the as-*
15 *sociation is located, or (ii) that has stock available for*
16 *purchase by entities other than savings and loan asso-*
17 *ciations of that State or by Federal associations having*
18 *their home offices in such State.”;*

19 (2) By amending subparagraph (C) to read as follows:

20 “(C) FOREIGN ASSISTANCE INVESTMENTS.—In-
21 vestments in housing project loans having the benefit
22 of any guaranty under section 221 of the Foreign As-
23 sistance Act of 1961 or loans having the benefit of any
24 guarantee under section 224 of such Act, or any com-
25 mitment or agreement with respect to such loans made

1 pursuant to either of such sections and in the share
2 capital and capital reserve of the Inter-American Sav-
3 ings and Loan Bank. This authority extends to the ac-
4 quisition, holding and disposition of loans having the
5 benefit of any guaranty under section 221 or 222 of
6 such Act as hereafter amended or extended, or of any
7 commitment or agreement for any such guaranty. In-
8 vestments under this subparagraph shall not exceed, in
9 the case of any association, 1 per centum of the assets
10 of such association.”;

11 (3) By striking subparagraph (D); and

12 (4) By adding thereto the following new subparagraph:

13 (D) **SMALL BUSINESS INVESTMENT COMPA-**
14 **NIES.**—An association may invest in stock, obligations,
15 or other securities of any small business investment
16 company formed pursuant to section 301(d) of the
17 Small Business Investment Act of 1958, for the pur-
18 pose of aiding members of the Federal Home Loan
19 Bank System, but no association may make any invest-
20 ment under this subparagraph if its aggregate out-
21 standing investment under this subparagraph would
22 exceed 1 per centum of the assets of such associ-
23 ation.”.

1 SEC. 211. Section 5(c) of the Home Owners' Loan Act
2 of 1933 (12 U.S.C. 1464(c)) is amended by adding a new
3 paragraph (8), to read as follows:

4 “(8) An association may engage in any activity or ven-
5 ture the Board determines to be incidental to the exercise of
6 the authority conferred by this subsection, or by subsection
7 (b).”.

8 SEC. 212. Section 5A(b)(1)(B) of the Federal Home
9 Loan Bank Act (12 U.S.C. 1425a(b)(1)(B)) is amended by
10 striking the words “and commercial banks”, and substituting
11 therefor the following: “, institutions that are, or are eligible
12 to become, members thereof, and commercial banks;”.

13 SEC. 213. Section 2(c) of the Bank Holding Company
14 Act (12 U.S.C. 1841(c)) is amended by adding after the word
15 “Islands” the following: “, except an institution the accounts
16 of which are insured by the Federal Savings and Loan Insur-
17 ance Corporation,”.

18 SEC. 214. Section 5 of the Home Owners' Loan Act of
19 1933 (12 U.S.C. 1464) is amended by adding a new subsec-
20 tion (p), to read as follows:

21 “(p) No association may establish, retain or operate a
22 branch outside the State in which the association has its
23 home office, unless the association qualifies as a domestic
24 building and loan association under section 7701(a)(19) of the
25 Internal Revenue Code or meets the asset composition test

1 its designation from a Federal Savings and Loan Association
2 to a Federal Savings Bank, or the reverse.

3 “(3) Any Federal association may convert itself into a
4 savings and loan or savings bank type of institution organized
5 pursuant to the laws of the State, district, commonwealth, or
6 territory (hereinafter referred to in this section as the
7 “State”) in which the principal office of such Federal associ-
8 ation is located: *Provided*, That (i) the State permits the con-
9 version of any savings and loan or savings bank type of insti-
10 tution of such State into a Federal association; (ii) that such
11 conversion of a Federal association into such a State institu-
12 tion is determined upon the vote in favor of such conversion
13 cast in person or by proxy at a special meeting of members or
14 stockholders called to consider such action, specified by the
15 law of the State in which the home office of the Federal
16 association is located, as required by such law for a State-
17 chartered institution to convert itself into a Federal associ-
18 ation, but in no event upon a vote of less than 51 per centum
19 of all the votes cast at such meeting, and upon compliance
20 with other requirements reciprocally equivalent to the re-
21 quirements of such State law for the conversion of a State-
22 chartered institution into a Federal association; (iii) that
23 notice of the meeting to vote on conversion shall be given as
24 herein provided and no other notice thereof shall be neces-
25 sary; the notice shall expressly state that :

1 called to vote thereon, as well as the time and place thereof.
 2 and such notice shall be mailed, postage prepaid, at least
 3 thirty and not more than sixty days prior to the date of the
 4 meeting, to each member or stockholder of record of the Fed-
 5 eral association at his last address as shown on the books of
 6 the Federal association and to the General Counsel of the
 7 Federal Home Loan Bank Board, Washington, D.C.; (iii) that, in the event of dissolution of a mutual
 8 association after conversion, the members or shareholders of
 9 the association will share on a mutual basis in the assets of
 10 the association in exact proportion to their relative share of
 11 account credits; (iv) that, in the event of dissolution of a stock
 12 association after conversion, the stockholders will share on
 13 an equitable basis in the assets of the association; and (v),
 14 that such conversion shall be effective upon the date that all
 15 the provisions of this Act shall have been fully complied with
 16 and upon the issuance of a new charter by the State wherein
 17 the association is located; it being provided that the act of
 18 converting into a State-chartered institution shall constitute
 19 an agreement to be bound by all the requirements that the
 20 Federal Savings and Loan Insurance Corporation may legal-
 21 ly impose under section 403 of title IV of the National Home-
 22 ing Act, as now or hereafter amended, and the association
 23 shall upon conversion and thereafter be authorized to issue
 24 securities currently approved at the time of conversion

25 securi

1 by the Federal Savings and Loan Insurance Corporation for
2 issuance by similar insured institutions in such State: *Pro-*
3 *vided*, That if the insurance of accounts is terminated in con-
4 nection with such conversion, the notice and other action
5 shall be taken as provided by law and regulations for the
6 termination of insurance of accounts.

7 “(4) Any aggrieved person may obtain review of a final
8 action of the Board or the Federal Savings and Loan Insur-
9 ance Corporation which approves, with or without conditions,
10 or disapproves a plan of conversion from the mutual to the
11 stock form, only by complying with the provisions of subsec-
12 tion (k) of section 408 of the National Housing Act within the
13 time limit and in the manner therein prescribed, which provi-
14 sions shall apply in all respects as if such final action were an
15 order the review of which is therein provided for, except that
16 such time limit shall commence upon publication of notice of
17 such final action in the Federal Register or upon the giving of
18 such general notice of final action as is required by or ap-
19 proved under regulations of the Corporation, whichever is
20 later.

21 “(5) To the extent authorized by the Board, (i) any Fed-
22 eral savings bank chartered as such prior to the enactment of
23 this paragraph may continue to make any investment or
24 engage in any activity not otherwise authorized under this
25 section, to the degree it was permitted to do so as a Federal

1 savings bank prior to such enactment, and (ii) any Federal
2 savings bank formerly organized as a mutual savings bank
3 under State law may continue to make any investment or
4 engage in any activity not otherwise authorized under this
5 section, to the degree it was authorized to do so as a mutual
6 savings bank under State law. The authority conferred by
7 this paragraph may be utilized by any Federal association
8 that acquires, by merger or consolidation, a Federal savings
9 bank enjoying grandfathered rights hereunder.”.

10 SEC. 105. Section 402(j) of the National Housing Act
11 (12 U.S.C. 1725(j)) is amended as follows:

12 (a) By amending paragraph (1) to read as follows:

13 “(1) Other than as provided in section 5 of the Home
14 Owners’ Loan Act of 1933, as amended, no insured institu-
15 tion may convert from the mutual to the stock form except in
16 accordance with the rules and regulations of the Corpora-
17 tion.”;

18 (b) By striking paragraphs (2), (3), (5), and (6),
19 and renumbering paragraph (4) as paragraph (2).

20 SEC. 106. Section 2(d) of the Home Owners’ Loan Act
21 of 1933 (12 U.S.C. 1462(d)) is amended by striking the word
22 “mutual” wherever it appears.

23 SEC. 107. Section 403(a) of the National Housing Act
24 (12 U.S.C. 1726(a)) is amended by striking the word
25 “mutual”.

1 SEC. 108. Section 408(a)(1)(A) of the National Housing
2 Act (12 U.S.C. 1730a(a)(1)(A)) is amended to read as fol-
3 lows:

4 “(A) ‘insured institution’ means a Federal savings
5 and loan association, a Federal savings bank, or a
6 building and loan, savings and loan, or homestead as-
7 sociation, or a cooperative bank, the accounts of which
8 are insured by the Federal Savings and Loan Insur-
9 ance Corporation;”.

10 TITLE II—INVESTMENTS

11 SEC. 201. Section 5(c)(1)(A) of the Home Owners’ Loan
12 Act of 1933 (12 U.S.C. 1464(c)(1)(A)) is amended to read as
13 follows:

14 “(A) ACCOUNT LOANS.—Loans on the security of
15 its savings accounts and loans specifically related to
16 transactions accounts.”.

17 SEC. 202. Section 5(c)(1)(B) of the Home Owners’ Loan
18 Act of 1933 (12 U.S.C. 1464(c)(1)(B)) is amended to read as
19 follows:

20 “(B) REAL PROPERTY LOANS.—Loans on the se-
21 curity of liens upon residential or nonresidential real
22 property.”.

23 SEC. 203. Section 5(c)(1)(G) of the Home Owners’ Loan
24 Act of 1933 (12 U.S.C. 1464(c)(1)(G)) is amended to read as
25 follows:

1 “(G) DEPOSITS.—Investments in the time depos-
2 its, certificates, or accounts of any bank the deposits of
3 which are insured by the Federal Deposit Insurance
4 Corporation, or in the savings accounts, certificates or
5 other accounts of any institution the accounts of which
6 are insured by the Federal Savings and Loan Insur-
7 ance Corporation.”.

8 SEC. 204. Section 5(c)(1)(H) of the Home Owners’ Loan
9 Act of 1933 (12 U.S.C. 1464(c)(1)(H)) is amended to read as
10 follows:

11 “(H) STATE SECURITIES.—Investments in obli-
12 gations of, or issued by, any State or political subdivi-
13 sion thereof (including any agency, corporation or in-
14 strumentality).”.

15 SEC. 205. Section 5(c)(1) of the Home Owners’ Loan
16 Act (12 U.S.C. 1464(c)(1)) is amended by striking subpara-
17 graph (L) and adding a new subparagraph (L), to read as
18 follows:

19 “(L) COMMERCIAL AND OTHER LOANS.—Secured
20 or unsecured loans for commercial, corporate, business
21 or agricultural purposes. No association may make
22 loans to one borrower under the authority provided by
23 this subparagraph in excess of the amount a national
24 bank having an identical total capital and surplus could
25 lend such borrower.”.

1 SEC. 206. Section 5(c)(1)(O) of the Home Owner's Loan
2 Act of 1933 (12 U.S.C. 1464(c)(1)(O)) is amended to read as
3 follows:

4 “(O) HOUSING AND LAND AND URBAN DEVELOP-
5 MENT INSURED OR GUARANTEED INVESTMENTS.—(i)
6 Loans secured by mortgages as to which the associ-
7 ation has the benefit of insurance under title X of the
8 National Housing Act or of a commitment or agree-
9 ment for such insurance, or (ii) loans as to which the
10 association has the benefit of any guarantee under title
11 IV of the Housing and Urban Development Act of
12 1968 or under part B of the National Urban Policy
13 and New Community Development Act of 1970 or
14 under section 802 of the Housing and Community De-
15 velopment Act of 1974 as now or hereafter in effect,
16 or of a commitment or agreement therefor.”.

17 SEC. 207. Section 5(c)(1) of the Home Owners' Loan
18 Act of 1933 (12 U.S.C. 1464(c)(1)) is amended by striking
19 subparagraph (P) and adding a new subparagraph (P), to read
20 as follows:

21 “(P) CORPORATE SECURITIES.—An association
22 may invest in, sell or hold commercial paper and cor-
23 porate debt securities, as defined and approved by the
24 Board. No association may make investments under
25 the authority provided by this subparagraph in the

1 paper or securities of one obligor or maker in excess of
2 the amount a national bank having identical total capi-
3 tal and surplus could so invest in the paper or securi-
4 ties of one obligor or maker.”.

5 SEC. 208. Section 5(c)(1)(Q) of the Home Owners’ Loan
6 Act of 1933 (12 U.S.C. 1464(c)(1)(Q)) is amended to read as
7 follows:

8 “(Q) INVESTMENT COMPANIES.—An association
9 may invest in, redeem or hold shares or certificates in
10 any open-end management investment company which
11 is registered with the Securities and Exchange Com-
12 mission under the Investment Company Act of 1940
13 and the portfolio of which is restricted by such man-
14 agement company’s investment policy, changeable only
15 if authorized by shareholder vote, primarily to such in-
16 vestments (without regard to any percentage-of-assets
17 restriction applicable to such investment under this
18 subsection) as an association by law or regulation may
19 invest in, sell, redeem, hold, or otherwise deal with.”.

20 SEC. 209. Section 5(c)(1) of the Home Owners’ Loan
21 Act of 1933 (12 U.S.C. 1464(c)(1)) is amended by adding a
22 new subparagraph (R), to read as follows:

23 “(R) CONSUMER LOANS.—An association may
24 make secured or unsecured loans for personal, family

97TH CONGRESS
1ST SESSION

S. 1703

To enhance the competitiveness of thrift institutions, to protect depositors and creditors of such institutions, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 5 (legislative day, SEPTEMBER 9), 1981

Mr. GAEN (by request) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To enhance the competitiveness of thrift institutions, to protect depositors and creditors of such institutions, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 TITLE I—FORM OF CHARTER: DEMAND

4 ACCOUNTS

5 SEC. 101. This Act may be cited as the “Thrift Institu-
6 tions Restructuring Act of 1981”.

7 SEC. 102. Section 5(a) of the Home Owners’ Loan Act
8 of 1933 (12 U.S.C. 1464(a)) is amended to read as follows:

1 “(a) In order to provide thrift institutions for the deposit
2 or investment of funds and for the extension of credit for
3 homes and other goods and services, the Board is authorized,
4 under such rules and regulations as it may prescribe, to pro-
5 vide for the organization, incorporation, examination, oper-
6 ation, and regulation of associations to be known as Federal
7 Savings and Loan Associations, or Federal Savings Banks,
8 and to issue charters therefor, giving primary consideration
9 to the best practices of thrift institutions in the United
10 States.”.

11 SEC. 103. Section 5(b) (1) and (2) of the Home Owners’
12 Loan Act of 1933 (12 U.S.C. 1464(b) (1) and (2)) are amend-
13 ed to read as follows:

14 “(b)(1) An association may raise capital in the form of
15 such savings deposits, shares, or other accounts, for fixed,
16 minimum, or indefinite periods of time (all of which are re-
17 ferred to in this section as savings accounts), or in the form of
18 such demand accounts, as are authorized by its charter or by
19 regulations of the Board, and may issue such passbooks, time
20 certificates of deposit, or other evidence of accounts as are so
21 authorized. All savings accounts and demand accounts shall
22 have the same priority upon liquidation. Holders of accounts
23 and obligors of an association shall, to such extent as may be
24 provided by its charter or by regulations of the Board, be
25 members of the association, and shall have such voting rights

1 and such other rights as are thereby provided. Except as may
2 be otherwise authorized by the association's charter or regu-
3 lation of the Board in the case of savings accounts for fixed
4 or minimum terms of not less than fourteen days, the pay-
5 ment of any savings account shall be subject to the right of
6 the association to require such advance notice, not less than
7 fourteen days, as shall be provided for by the charter of the
8 association or the regulations of the Board. The payment of
9 withdrawals from accounts in the event an association does
10 not pay all withdrawals in full (subject to the right of the
11 association, where applicable, to require notice) shall be sub-
12 ject to such rules and procedures as may be prescribed by the
13 association's charter or by regulation of the Board, but any
14 association which, except as authorized in writing by the
15 Board, fails to make full payment of any withdrawal when
16 due shall be deemed to be in an unsafe or unsound condition
17 to transact business within the meaning of subsection (d) of
18 this section. Accounts may be subject to check or to with-
19 drawal or transfer on negotiable or transferable or other
20 order or authorization to the association, as the Board may
21 by regulation provide. Notwithstanding any limitations of this
22 section, associations may establish remote service units for
23 the purpose of crediting savings or demand accounts, debiting
24 such accounts, crediting payments on loans, and the disposi-

1 tion of related financial transactions, as provided in regula-
2 tions prescribed by the Board.

3 “(2) To such extent as the Board may authorize by reg-
4 ulation or advise in writing, an association may borrow, may
5 give security, may be surety as defined by the Board and
6 may issue such notes, bonds, debentures, or other obligations,
7 or other securities, including capital stock, as the Board may
8 so authorize.”.

9 SEC. 104. Section 5(i) of the Home Owners' Loan Act
10 of 1933 (12 U.S.C. 1464(i)) is amended to read as follows:

11 “(i)(1) Any institution that is, or is eligible to become, a
12 member of a Federal Home Loan Bank may convert itself
13 into a Federal Savings and Loan Association or Federal Sav-
14 ings Bank under this Act (and in so doing may change direct-
15 ly from the mutual form to the stock form, or the reverse),
16 but such conversion shall be subject to such rules and regula-
17 tions as the Board shall prescribe, and thereafter the convert-
18 ed association shall be entitled to all the benefits of this sec-
19 tion and shall be subject to examination and regulation to the
20 same extent as other associations incorporated pursuant this
21 Act.

22 “(2) Subject to the rules and regulations of the Board,
23 any Federal association may convert itself from the mutual
24 form to the stock form of organization, or from the stock form
25 to the mutual form, and any Federal association may change

1 its designation from a Federal Savings and Loan Association
2 to a Federal Savings Bank, or the reverse.

3 “(3) Any Federal association may convert itself into a
4 savings and loan or savings bank type of institution organized
5 pursuant to the laws of the State, district, commonwealth, or
6 territory (hereinafter referred to in this section as the
7 “State”) in which the principal office of such Federal associ-
8 ation is located: *Provided*, That (i) the State permits the con-
9 version of any savings and loan or savings bank type of insti-
10 tution of such State into a Federal association; (ii) that such
11 conversion of a Federal association into such a State institu-
12 tion is determined upon the vote in favor of such conversion
13 cast in person or by proxy at a special meeting of members or
14 stockholders called to consider such action, specified by the
15 law of the State in which the home office of the Federal
16 association is located, as required by such law for a State-
17 chartered institution to convert itself into a Federal associ-
18 ation, but in no event upon a vote of less than 51 per centum
19 of all the votes cast at such meeting, and upon compliance
20 with other requirements reciprocally equivalent to the re-
21 quirements of such State law for the conversion of a State-
22 chartered institution into a Federal association; (iii) that
23 notice of the meeting to vote on conversion shall be given as
24 herein provided and no other notice thereof shall be neces-
25 sary; the notice shall expressly state that such meeting is

1 called to vote thereon, as well as the time and place thereof,
2 and such notice shall be mailed, postage prepaid, at least
3 thirty and not more than sixty days prior to the date of the
4 meeting, to each member or stockholder of record of the Fed-
5 eral association at his last address as shown on the books of
6 the Federal association and to the General Counsel of the
7 Federal Home Loan Bank Board, Washington, District of
8 Columbia; (iv) that, in the event of dissolution of a mutual
9 association after conversion, the members or shareholders of
10 the association will share on a mutual basis in the assets of
11 the association in exact proportion to their relative share or
12 account credits; (v) that, in the event of dissolution of a stock
13 association after conversion, the stockholders will share on
14 an equitable basis in the assets of the association; and (vi)
15 that such conversion shall be effective upon the date that all
16 the provisions of this Act shall have been fully complied with
17 and upon the issuance of a new charter by the State wherein
18 the association is located; it being provided that its act of
19 converting into a State-chartered institution shall constitute
20 an agreement to be bound by all the requirements that the
21 Federal Savings and Loan Insurance Corporation may legal-
22 ly impose under section 403 of title IV of the National Hous-
23 ing Act, as now or hereafter amended, and the association
24 shall upon conversion and thereafter be authorized to issue
25 securities in any form currently approved at the time of issue

1 by the Federal Savings and Loan Insurance Corporation for
2 issuance by similar insured institutions in such State: *Pro-*
3 *vided*, That if the insurance of accounts is terminated in con-
4 nection with such conversion, the notice and other action
5 shall be taken as provided by law and regulations for the
6 termination of insurance of accounts.

7 “(4) Any aggrieved person may obtain review of a final
8 action of the Board or the Federal Savings and Loan Insur-
9 ance Corporation which approves, with or without conditions,
10 or disapproves a plan of conversion from the mutual to the
11 stock form, only by complying with the provisions of subsec-
12 tion (k) of section 408 of the National Housing Act within the
13 time limit and in the manner therein prescribed, which provi-
14 sions shall apply in all respects as if such final action were an
15 order the review of which is therein provided for, except that
16 such time limit shall commence upon publication of notice of
17 such final action in the Federal Register or upon the giving of
18 such general notice of final action as is required by or ap-
19 proved under regulations of the Corporation, whichever is
20 later.

21 “(5) To the extent authorized by the Board, (i) any Fed-
22 eral savings bank chartered as such prior to the enactment of
23 this paragraph may continue to make any investment or
24 engage in any activity not otherwise authorized under this
25 section, to the degree it was permitted to do so as a Federal

1 savings bank prior to such enactment, and (ii) any Federal
2 savings bank formerly organized as a mutual savings bank
3 under State law may continue to make any investment or
4 engage in any activity not otherwise authorized under this
5 section, to the degree it was authorized to do so as a mutual
6 savings bank under State law. The authority conferred by
7 this paragraph may be utilized by any Federal association
8 that acquires, by merger or consolidation, a Federal savings
9 bank enjoying grandfathered rights hereunder.”.

10 SEC. 105. Section 402(j) of the National Housing Act
11 (12 U.S.C. 1725(j)) is amended as follows:

12 (a) By amending paragraph (1) to read as follows:

13 “(1) Other than as provided in section 5 of the Home
14 Owners’ Loan Act of 1933, as amended, no insured institu-
15 tion may convert from the mutual to the stock form except in
16 accordance with the rules and regulations of the Corpora-
17 tion.”;

18 (b) By striking paragraphs (2), (3), (5), and (6),
19 and renumbering paragraph (4) as paragraph (2).

20 SEC. 106. Section 2(d) of the Home Owners’ Loan Act
21 of 1933 (12 U.S.C. 1462(d)) is amended by striking the word
22 “mutual” wherever it appears.

23 SEC. 107. Section 403(a) of the National Housing Act
24 (12 U.S.C. 1726(a)) is amended by striking the word
25 “mutual”.

1 SEC. 108. Section 408(a)(1)(A) of the National Housing
2 Act (12 U.S.C. 1730a(a)(1)(A)) is amended to read as fol-
3 lows:

4 “(A) ‘insured institution’ means a Federal savings
5 and loan association, a Federal savings bank, or a
6 building and loan, savings and loan, or homestead as-
7 sociation, or a cooperative bank, the accounts of which
8 are insured by the Federal Savings and Loan Insur-
9 ance Corporation;”.

10 **TITLE II—INVESTMENTS**

11 SEC. 201. Section 5(c)(1)(A) of the Home Owners’ Loan
12 Act of 1933 (12 U.S.C. 1464(c)(1)(A)) is amended to read as
13 follows:

14 “(A) ACCOUNT LOANS.—Loans on the security of
15 its savings accounts and loans specifically related to
16 transactions accounts.”.

17 SEC. 202. Section 5(c)(1)(B) of the Home Owners’ Loan
18 Act of 1933 (12 U.S.C. 1464(c)(1)(B)) is amended to read as
19 follows:

20 “(B) REAL PROPERTY LOANS.—Loans on the se-
21 curity of liens upon residential or nonresidential real
22 property.”.

23 SEC. 203. Section 5(c)(1)(G) of the Home Owners’ Loan
24 Act of 1933 (12 U.S.C. 1464(c)(1)(G)) is amended to read as
25 follows:

1 “(G) DEPOSITS.—Investments in the time depos-
2 its, certificates, or accounts of any bank the deposits of
3 which are insured by the Federal Deposit Insurance
4 Corporation, or in the savings accounts, certificates or
5 other accounts of any institution the accounts of which
6 are insured by the Federal Savings and Loan Insur-
7 ance Corporation.”.

8 SEC. 204. Section 5(c)(1)(H) of the Home Owners’ Loan
9 Act of 1933 (12 U.S.C. 1464(c)(1)(H)) is amended to read as
10 follows:

11 “(H) STATE SECURITIES.—Investments in obli-
12 gations of, or issued by, any State or political subdivi-
13 sion thereof (including any agency, corporation or in-
14 strumentality).”.

15 SEC. 205. Section 5(c)(1) of the Home Owners’ Loan
16 Act (12 U.S.C. 1464(c)(1)) is amended by striking subpara-
17 graph (L) and adding a new subparagraph (L), to read as
18 follows:

19 “(L) COMMERCIAL AND OTHER LOANS.—Secured
20 or unsecured loans for commercial, corporate, business
21 or agricultural purposes. No association may make
22 loans to one borrower under the authority provided by
23 this subparagraph in excess of the amount a national
24 bank having an identical total capital and surplus could
25 lend such borrower.”.

1 SEC. 206. Section 5(c)(1)(O) of the Home Owner's Loan
2 Act of 1933 (12 U.S.C. 1464(c)(1)(O)) is amended to read as
3 follows:

4 “(O) HOUSING AND LAND AND URBAN DEVELOP-
5 MENT INSURED OR GUARANTEED INVESTMENTS.—(i)
6 Loans secured by mortgages as to which the associ-
7 ation has the benefit of insurance under title X of the
8 National Housing Act or of a commitment or agree-
9 ment for such insurance, or (ii) loans as to which the
10 association has the benefit of any guarantee under title
11 IV of the Housing and Urban Development Act of
12 1968 or under part B of the National Urban Policy
13 and New Community Development Act of 1970 or
14 under section 802 of the Housing and Community De-
15 velopment Act of 1974 as now or hereafter in effect,
16 or of a commitment or agreement therefor.”.

17 SEC. 207. Section 5(c)(1) of the Home Owners' Loan
18 Act of 1933 (12 U.S.C. 1464(c)(1)) is amended by striking
19 subparagraph (P) and adding a new subparagraph (P), to read
20 as follows:

21 “(P) CORPORATE SECURITIES.—An association
22 may invest in, sell or hold commercial paper and cor-
23 porate debt securities, as defined and approved by the
24 Board. No association may make investments under
25 the authority provided by this subparagraph in the

1 paper or securities of one obligor or maker in excess of
2 the amount a national bank having identical total capital
3 and surplus could so invest in the paper or securities
4 of one obligor or maker.”.

5 SEC. 208. Section 5(c)(1)(Q) of the Home Owners’ Loan
6 Act of 1933 (12 U.S.C. 1464(c)(1)(Q)) is amended to read as
7 follows:

8 “(Q) INVESTMENT COMPANIES.—An association
9 may invest in, redeem or hold shares or certificates in
10 any open-end management investment company which
11 is registered with the Securities and Exchange Commission
12 under the Investment Company Act of 1940
13 and the portfolio of which is restricted by such management
14 company’s investment policy, changeable only
15 if authorized by shareholder vote, primarily to such investments
16 (without regard to any percentage-of-assets
17 restriction applicable to such investment under this
18 subsection) as an association by law or regulation may
19 invest in, sell, redeem, hold, or otherwise deal with.”.

20 SEC. 209. Section 5(c)(1) of the Home Owners’ Loan
21 Act of 1933 (12 U.S.C. 1464(c)(1)) is amended by adding a
22 new subparagraph (R), to read as follows:

23 “(R) CONSUMER LOANS.—An association may
24 make secured or unsecured loans for personal, family

1 or household purposes, and loans reasonably incident to
2 the provision of such credit.”.

3 SEC. 210. Section 5(c) of the Home Owners’ Loan Act
4 of 1933 (12 U.S.C. 1464(c)) is amended by:

5 (a) Striking paragraph (2);

6 (b) Redesignating paragraph (6) as paragraph (5);

7 (c) Adding new paragraph (2), to read as follows:

8 “(2) INVESTMENTS IN PERSONALTY.—An associ-
9 ation may invest in tangible personal property, includ-
10 ing, without limitation, vehicles, mobile homes, ma-
11 chinery, equipment, or furniture, and may hold such
12 property for rental or sale, but such investment is lim-
13 ited to not in excess of 10 per centum of the assets of
14 the association.”;

15 (d) Amending paragraph (3) as follows:

16 (1) By striking subparagraph (D); and

17 (2) By amending subparagraph (A) to read as fol-
18 lows:

19 “(A) EDUCATION LOANS.—Loans made for the
20 payment of educational expenses.”, and

21 (e) Amending paragraph (4) as follows:

22 (1) By amending subparagraph (B) to read as fol-
23 lows:

24 “(B) SERVICE CORPORATIONS.—Investments in
25 the capital stock, obligations, or other securities of any

1 corporation organized under the laws of the State in
2 which the home office of the association is located, if
3 the entire capital stock of such corporation is available
4 for purchase only by savings and loan associations of
5 that State and by Federal associations having their
6 home offices therein, but no association may make any
7 investment under this subparagraph if its aggregate
8 outstanding investment under this subparagraph would
9 exceed 5 per centum of the assets of the association:
10 *Provided, That an association may make an investment*
11 *under this subparagraph notwithstanding that the serv-*
12 *ice corporation in which investment is authorized has*
13 *invested in any other corporation (i) that is not char-*
14 *tered by the State in which the home office of the as-*
15 *sociation is located, or (ii) that has stock available for*
16 *purchase by entities other than savings and loan asso-*
17 *ciations of that State or by Federal associations having*
18 *their home offices in such State.”;*

19 (2) By amending subparagraph (C) to read as follows:

20 “(C) FOREIGN ASSISTANCE INVESTMENTS.—In-
21 vestments in housing project loans having the benefit
22 of any guaranty under section 221 of the Foreign As-
23 sistance Act of 1961 or loans having the benefit of any
24 guarantee under section 224 of such Act, or any com-
25 mitment or agreement with respect to such loans made

1 pursuant to either of such sections and in the share
2 capital and capital reserve of the Inter-American Sav-
3 ings and Loan Bank. This authority extends to the ac-
4 quisition, holding and disposition of loans having the
5 benefit of any guaranty under section 221 or 222 of
6 such Act as hereafter amended or extended, or of any
7 commitment or agreement for any such guaranty. In-
8 vestments under this subparagraph shall not exceed, in
9 the case of any association, 1 per centum of the assets
10 of such association.”;

11 (3) By striking subparagraph (D); and

12 (4) By adding thereto the following new subparagraph:

13 (D) **SMALL BUSINESS INVESTMENT COMPA-**
14 **NIES.**—An association may invest in stock, obligations,
15 or other securities of any small business investment
16 company formed pursuant to section 301(d) of the
17 Small Business Investment Act of 1958, for the pur-
18 pose of aiding members of the Federal Home Loan
19 Bank System, but no association may make any invest-
20 ment under this subparagraph if its aggregate out-
21 standing investment under this subparagraph would
22 exceed 1 per centum of the assets of such associ-
23 ation.”.

1 SEC. 211. Section 5(c) of the Home Owners' Loan Act
2 of 1933 (12 U.S.C. 1464(c)) is amended by adding a new
3 paragraph (8), to read as follows:

4 “(8) An association may engage in any activity or ven-
5 ture the Board determines to be incidental to the exercise of
6 the authority conferred by this subsection, or by subsection
7 (b).”.

8 SEC. 212. Section 5A(b)(1)(B) of the Federal Home
9 Loan Bank Act (12 U.S.C. 1425a(b)(1)(B)) is amended by
10 striking the words “and commercial banks”, and substituting
11 therefor the following: “, institutions that are, or are eligible
12 to become, members thereof, and commercial banks;”.

13 SEC. 213. Section 2(c) of the Bank Holding Company
14 Act (12 U.S.C. 1841(c)) is amended by adding after the word
15 “Islands” the following: “, except an institution the accounts
16 of which are insured by the Federal Savings and Loan Insur-
17 ance Corporation,”.

18 SEC. 214. Section 5 of the Home Owners' Loan Act of
19 1933 (12 U.S.C. 1464) is amended by adding a new subsec-
20 tion (p), to read as follows:

21 “(p) No association may establish, retain or operate a
22 branch outside the State in which the association has its
23 home office, unless the association qualifies as a domestic
24 building and loan association under section 7701(a)(19) of the
25 Internal Revenue Code or meets the asset composition test

1 imposed by paragraph (C) of that section on institutions seek-
2 ing so to qualify. No out-of-State branch so established shall
3 be retained or operated unless the total assets of the associ-
4 ation attributable to all branches of the association in that
5 State would qualify the branches as a whole, were they oth-
6 erwise eligible, for treatment as a domestic building and loan
7 association under said section 7701(a)(19). The limitations of
8 this subsection shall not apply if (1) the branch results from a
9 transaction authorized under section 408(m) of the National
10 Housing Act; (2) the branch was authorized for the associ-
11 ation prior to the enactment of the Thrift Institutions Re-
12 structuring Act of 1981; (3) the law of the State in which the
13 branch is or is to be located would permit establishment of
14 the branch were the association an institution of the savings
15 and loan or savings bank type chartered by the State in
16 which its home office is located; or (4) the branch was operat-
17 ed lawfully as a branch under State law prior to the associ-
18 ation's conversion to a Federal charter. The Board, for good
19 cause shown, may allow associations up to two years to
20 comply with the requirements of this subsection."

21 SEC. 215. Section 408 of the National Housing Act (12
22 U.S.C. 1730a) is amended by adding new subsection (n), to
23 read as follows:

24 "(n) No savings and loan holding company, nor any sub-
25 sidiary thereof which is not an insured institution, whose sub-

10 SEC. 301. Section 501 of Public Law 96-221 (12
11 U.S.C. 1735f-7 note) is amended by redesignating subsec-
12 tions (f) and (g) as subsections (g) and (h) respectively, and
13 adding a new subsection (f), to read as follows:

14 “(f) The provisions of the constitution or the laws of any
15 State limiting the ability of any lender to enter into contracts,
16 or to enforce contracts, whenever executed, providing that
17 the lender may, at its option, declare due and payable sums
18 secured by the lender’s security instrument if all or any part
19 of the property, or an interest therein, securing the loan is
20 sold or transferred by the borrower without the lender’s prior
21 written consent shall not apply to contracts involving loans
22 secured by a lien or residential real property, by a lien on
23 stock allocated to a dwelling unit in a residential cooperative
24 housing project, or by a lien on a residential manufactured
25 home, where such loans are originated or held by institutions

1 chartered by the Federal Home Loan Bank Board, the
2 Comptroller of the Currency or the National Credit Union
3 Administration Board. Except as limited by the Federal
4 Home Loan Bank Board pursuant to subsection (g) herein,
5 exercise by the institution (or its transferees) of such option
6 (hereafter called a due-on-sale clause) shall be exclusively
7 governed by the terms of the loan contract, and all rights and
8 remedies of the institution (or its transferees) and borrower
9 shall be fixed and governed by the contract. In the exercise
10 of its authority under subsection (g), the Board may require
11 institutions to observe appropriate consumer safeguards.”.

12 SEC. 302. Subsection (g) of Section 501 of Public Law
13 96-221 (12 U.S.C. 1735f-7 note) is amended to read as fol-
14 lows:

15 “(g)(1) The Federal Home Loan Bank Board is author-
16 ized to—

17 “(A) issue rules, regulations, interpretations, or
18 approvals governing the implementation of this section;
19 and

20 “(B) delegate authority to duly authorized offi-
21 cials, employees or agents of the Board, of the Comp-
22 troller of the Currency, or of the National Credit
23 Union Administration Board to issue interpretations or
24 approvals governing the implementation of this section.

1 “(2) No provision of the constitution or laws of any
2 State imposing any liability, penalty, or forfeiture shall apply
3 to any act done or omitted in good faith in conformity with
4 any rule, regulation, interpretation, or approval under this
5 section by the Federal Home Loan Bank Board or in con-
6 formity with any interpretation or approval by an official,
7 employee or agent of the Board, or of the Comptroller of the
8 Currency, or of the National Credit Union Administration
9 Board duly authorized by the Board to issue interpretations
10 or approvals under this section under such procedures as the
11 Board may prescribe therefor, notwithstanding that, after
12 such act or omission has occurred, such rule, regulation, or
13 approval is amended, rescinded, or determined by judicial or
14 other authority to be invalid for any reason.”.

15 SEC. 303. Subsection (h) of Section 501 of Public Law
16 96-221 (12 U.S.C. 1735f-7 note) is amended by striking the
17 period and adding the words “, except for subsection (f).”.

18 TITLE IV—EXTRAORDINARY AUTHORITY

19 SEC. 401. (a) Section 408 of the National Housing Act
20 (12 U.S.C. 1730a)) is amended by adding a new subsection
21 (m), as follows:

22 “(m) Notwithstanding any other provision of State or
23 Federal law, except as provided in subsections (e)(2) and (1)
24 hereof, and in the third sentence of this subparagraph, the
25 Corporation, upon its determination that severe financial con-

1 ditions exist which threaten the stability of a significant
2 number of insured institutions, or of insured institutions pos-
3 sessing significant financial resources, may authorize, in its
4 discretion and where it determines such authorization would
5 lessen the risk to the Corporation, an insured institution that
6 is eligible for assistance pursuant to section 406(f) of this Act
7 to merge or consolidate with, or to transfer its assets and
8 liabilities to, any other insured institution or any insured bank
9 (as that term insured bank is defined in section 3(h) of the
10 Federal Deposit Insurance Act (12 U.S.C. 1813(h)), may au-
11 thorize any other insured institution to acquire control of said
12 insured institution, or may authorize any company to acquire
13 control of said insured institution or to acquire the assets or
14 assume the liabilities thereof. Mergers, consolidations, trans-
15 fers, and acquisitions under this subsection shall be on such
16 terms as the Corporation shall provide. Where otherwise re-
17 quired by law, transactions under this subsection must be ap-
18 proved by the primary Federal supervisor of the party there-
19 to that is not an insured institution. In considering authoriza-
20 tion under this subsection, the need to minimize financial as-
21 sistance required of the Corporation shall be the paramount
22 consideration, but the Corporation shall make a reasonable
23 effort to authorize transactions under this subsection in the
24 following sequence: First, between institutions of the same
25 type within the same State; second, between institutions of

1 the same type in different States; third between institutions
2 -of different types in the same State; and fourth, between in-
3 stitutions of different types in different States. As used herein
4 the term type shall refer to the purpose of the organizations
5 and the general nature of their powers rather than to the
6 identity of the charterers or their form of corporate organiza-
7 tion.”.

8 (b) Section 4(c)(8) of the Bank Holding Company Act
9 (12 U.S.C. 1843(c)(8)) is amended by adding at the end
10 thereof the following: “Notwithstanding any other provision
11 of this Act, if the Board finds that an emergency exists which
12 requires it to act immediately on any application under this
13 subsection involving a thrift institution, and the primary Fed-
14 eral regulator of such institution concurs in said finding, the
15 Board may dispense with the notice and hearing requirement
16 of this subsection and the Board may approve or deny any
17 such application without notice or hearing.”.

18 SEC. 402. Section 408(e)(2) of the National Housing
19 Act (12 U.S.C. 1730a(e)(2)) is amended as follows:

20 (a) By adding in the first sentence immediately after the
21 term “subsection” the following: “, or any transaction under
22 subsection (m) hereof,”.

23 (b) By adding in the third sentence thereof immediately
24 after the word “acquisition,” the following: “except a trans-
25 action under subsection (m) hereof,”.

1 SEC. 403. (a) Section 5 of the Home Owners' Loan Act
2 of 1933 (12 U.S.C. 1464) is amended by adding at the end
3 thereof the following:

4 “(o) Notwithstanding any other provision of this section
5 or State law, and consistent with the purposes of this Act,
6 the Board may authorize (or in the case of a Federal associ-
7 ation, require) the conversion of a mutual savings and loan
8 association or mutual savings bank into a Federal stock sav-
9 ings and loan association or Federal stock savings bank, or
10 charter a Federal stock savings and loan association or Fed-
11 eral stock savings bank to acquire the assets of, or merge
12 with such a mutual institution under the rules and regulations
13 of the Board. The Board may condition its approval of the
14 conversion or acquisition of a mutual savings bank under this
15 subsection that was previously insured by the Federal Depos-
16 it Insurance Corporation upon the receipt from the Federal
17 Deposit Insurance Corporation of reasonable indemnification
18 of the Federal Savings and Loan Insurance Corporation for
19 losses that may be incurred by the latter as a consequence of
20 its insuring the accounts of such institution, as agreed to by
21 the Corporations, and the Federal Deposit Insurance Corpo-
22 ration is authorized to pay such indemnification, without
23 regard to any other provision of law. Authorizations under
24 this subsection may be made only to assist an institution in
25 receivership, or if the primary Federal supervisor has deter-

1 mined that severe financial conditions exist which threaten
2 the stability of any institution, or when either the Corpora-
3 tions had contracted to provide assistance to such institution
4 under section 406 of the National Housing Act or section 13
5 of the Federal Deposit Insurance Act.”.

6 (b) Section 2(i) of the Bank Holding Company Act (12
7 U.S.C. 1841(i)) is amended by adding after the word
8 “shares” the following: “or, (4) a Federal stock savings bank
9 or savings and loan association organized under section 5(o)
10 of the Home Owners’ Loan Act of 1933 (12 U.S.C.
11 1464(o)).”.

12 SEC. 404. Section 406(f)(2) of the National Housing Act
13 (12 U.S.C. 1729(f)(2)) is amended by adding the following
14 sentence to read as follows:

15 “(2) The Corporation may provide any party acquiring
16 control of, merging with, consolidating with or acquiring the
17 assets of an insured institution under section 408(m) of this
18 Act with such financial assistance as it could provide an in-
19 sured institution under this subsection.”.

20 SEC. 405. (a) Section 406(a) of the National Housing
21 Act (12 U.S.C. 1729(a)) is amended by striking the phrase
22 “savings and loan”.

23 (b) Section 406(b) of the National Housing Act (12
24 U.S.C. 1729(b)) is amended to read as follows:

1 “(b) In the event that a Federal association is in default,
2 the Corporation shall be appointed as conservator or receiver
3 and as such (1) is authorized (i) to take over the assets of and
4 operate such association, (ii) to take such action as may be
5 necessary to put it in a sound and solvent condition, (iii) to
6 merge it with another insured institution, (iv) to organize a
7 new Federal association to take over its assets, (v) to proceed
8 to liquidate its assets in an orderly manner, or (vi) to make
9 such other disposition of the matter as it deems to be in the
10 best interest of the association, its savers, and the Corpora-
11 tion, and (2) shall pay all valid credit obligations of the asso-
12 ciation. The Corporation shall pay insurance as provided in
13 section 405. The surrender and transfer to the Corporation of
14 an insured account in any such association which is in default
15 shall subrogate the Corporation with respect to such insured
16 account, but shall not affect any right which the insured
17 member may have in the uninsured portion of his account or
18 any right which he may have to participate in the distribution
19 of the net proceeds remaining from the disposition of the
20 assets of such association.”.

21 (c) Section 406(c) of the National Housing Act (12
22 U.S.C. 1729(c)) is amended by striking the phrase “savings
23 and loan” wherever it appears.

24 (d) Section 406(c)(1) of the National Housing Act (12
25 U.S.C. 1729(c)(1)) is amended by adding the letter “(A)” im-

1 immediately after the phrase "(c)(1)", and by adding a new sub-
2 paragraph (B), to read as follows:

3 “(B) Notwithstanding any provision of State law, or of
4 this section, in the event the Federal Home Loan Bank
5 Board determines that any of the grounds specified in section
6 5(d)(6)(A) (i), (ii), or (iii) of the Home Owners’ Loan Act of
7 1933 exist with respect to an insured institution, other than a
8 Federal association, the Board shall have exclusive power
9 and jurisdiction to appoint the Corporation as sole conserva-
10 tor or receiver of such institution. In such cases the Corpora-
11 tion shall have the same powers and duties with respect to
12 insured institutions as are conferred upon it under subsection
13 (b) of this section with respect to Federal associations.”.

14 (e) Section 406(c)(2) of the National Housing Act (12
15 U.S.C. 1729(c)(2)) is amended by adding the words “conser-
16 vator or” immediately after the word “sole” in the first sen-
17 tence.

18 (f) Section 406(c)(3) of the National Housing Act (12
19 U.S.C. 1729(c)(3)) is amended as follows:

20 (1) By adding the phrase “conservator or” immediately
21 prior to the word “receiver” wherever it appears therein;

22 (2) By striking the phrase “paragraph (2)” and substi-
23 tuting therefor the phrase “paragraphs (1) or (2)”; and

24 (3) By striking the second sentence thereof.

1 (g) Section 406(d) of the National Housing Act (12
2 U.S.C. 1729(d)) is amended to read as follows:

3 “(d) In connection with the liquidation of insured institu-
4 tions, the Corporation shall have power to carry on the busi-
5 ness of and to collect all obligations to the insured institu-
6 tions, to settle, compromise, or release claims in favor of or
7 against the insured institutions, and to do all other things
8 that may be necessary in connection therewith, subject only
9 to the regulation of the Federal Home Loan Bank Board, or,
10 in cases where the Corporation has been appointed conserva-
11 tor, receiver, or legal custodian solely by a public authority
12 having jurisdiction over the matter other than said Board,
13 subject only to the regulation of such public authority.”.

14 SEC. 406. Section 16 of the Federal Home Loan Bank
15 Act (12 U.S.C. 1436) is amended by inserting “(a)” after
16 “SEC. 16.” and adding at the end thereof the following:

17 “(b) Notwithstanding subsection (a) or any other provi-
18 sion of this Act, if the Board determines that severe financial
19 conditions exist threatening the stability of member institu-
20 tions, it may suspend temporarily the requirements under
21 subsection (a) that a portion of net earnings be set aside semi-
22 annually by each Federal Home Loan Bank to a reserve ac-
23 count and permit each Federal Home Loan Bank to declare
24 and pay dividends out of undivided profits. Thereafter, divi-
25 dends shall be paid in accordance with subsection (a).”.

1 SEC. 407. (a) Section 402(d) of the National Housing
2 Act (12 U.S.C. 1725(d)) is amended by striking the period at
3 the end of the first sentence and adding the following: “,
4 except that interest on loans from the Federal Home Loan
5 Banks shall be not less than their current marginal cost of
6 funds, taking into account the maturities involved, and loans
7 from the Federal Home Loan Banks shall be adequately se-
8 cured, as determined by the Federal Home Loan Bank
9 Board.”.

10 (b) Section 402(i) of the National Housing Act (12
11 U.S.C. 1725(i)) is amended as follows:

12 (1) In the first sentence, immediately after the
13 word “source”, by adding the following: “, except the
14 Federal Home Loan Banks”; and

15 (2) In the first sentence, immediately after the
16 first time the word “loan” appears subsequent to the
17 first colon, by adding the words “from the Treasury”.

18 (c) Section 11 of the Federal Home Loan Bank Act (12
19 U.S.C. 1431) is amended by adding a new subsection (k), as
20 follows:

21 “(k) The Federal Home Loan Banks are authorized to
22 make loans to the Federal Savings and Loan Insurance Cor-
23 poration, as directed by the Board, but subject to section
24 402(d) of the National Housing Act.”.

1 SEC. 408. Section 404 of the National Housing Act (12
2 U.S.C. 1727) is amended by redesignating subsection (h) as
3 subsection (i) and adding a new subsection (h), as follows:

4 “(h) Notwithstanding any other provision of this section,
5 the Corporation, upon its determination that extraordinary
6 financial conditions exist increasing the risk to the Corpora-
7 tion, may terminate distribution of shares of the secondary
8 reserve and utilize said reserve on the same basis as the pri-
9 mary reserve. If otherwise authorized, the Corporation may
10 resume such distribution upon its determination that said con-
11 ditions no longer exist.”.

12 TITLE V—MISCELLANEOUS

13 SEC. 501. Section 17(a) of the Federal Home Loan
14 Bank Act (12 U.S.C. 1437(a)) is amended by adding a new
15 sentence immediately after the first sentence, to read as fol-
16 lows: “Notwithstanding any other provision of law, the
17 Board may from time to time make such provision as it
18 deems appropriate authorizing the performance by any offi-
19 cer, employee, agent or administrative unit thereof of any
20 function of the Board (including any function of the Federal
21 Savings and Loan Insurance Corporation), except with
22 regard to promulgation of rules and regulations in accordance
23 with the Administrative Procedures Act, and adjudications
24 subject to such Act.”.

1 SEC. 502. Section 5(d)(8)(A) of the Home Owners' Loan
2 Act of 1933 (12 U.S.C. 1464(d)(8)(A)) is amended by adding
3 in the last sentence thereof, immediately after the word
4 "party", the following: ", which prevails,".

5 SEC. 503. (a) Section 305(a)(1) and (b) of the Federal
6 Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)
7 (1) and (b)) are amended by inserting "the Federal Deposit
8 Insurance Corporation, the National Credit Union Adminis-
9 tration," after "Federal Savings and Loan Insurance Corpo-
10 ration," each place it appears.

11 (b) Section 305(a)(2) of the Federal Home Loan Mort-
12 gage Corporation Act (12 U.S.C. 1454(a)(2)) is amended by
13 amending the third sentence to read as follows: "The Corpo-
14 ration may purchase a conventional mortgage which was
15 originated more than one year prior to the purchase date only
16 if the seller is the Federal Deposit Insurance Corporation,
17 the Federal Savings and Loan Insurance Corporation, the
18 National Credit Union Administration, or any other sellers
19 currently engaged in mortgage lending or investing activi-
20 ties."

21 (c) Section 303(h) of the Federal Home Loan Mortgage
22 Corporation Act (12 U.S.C. 1451(h)) is amended by striking
23 out the word "first".

24 SEC. 504. Section 10 of the Federal Home Loan Bank
25 Act (12 U.S.C. 1430) is amended as follows:

1 (a) By deleting the first two sentences of subsection (b);

2 (b) By amending subsection (a) to read as follows:

3 "Each Federal Home Loan Bank is authorized to make se-
4 cured advances to its members upon such security as the
5 Board may prescribe."; and

6 (c) By deleting the word "twelve" wherever it appears
7 in subsection (c) and substituting therefor the word "twenty".

8 SEC. 505. Section 405(a) of the National Housing Act
9 (12 U.S.C. 1728(a)) is amended by adding after the first sen-
10 tence the following: "Whenever the liabilities of an insured
11 institution for accounts shall have been assumed by another
12 insured institution or institutions, whether by way of merger,
13 consolidation, or other statutory assumption, or pursuant to
14 contract, all accounts so assumed shall have separate insur-
15 ance which shall terminate at the end of six months from the
16 date such assumption takes effect or, in the case of any certif-
17 icate account, the earliest maturity date after the six-month
18 period."

19 SEC. 506. Section 6(c)(2) of the Federal Home Loan
20 Bank Act (12 U.S.C. 1426(c)(2)) is amended to read as fol-
21 lows:

22 "(2) Notwithstanding any other provision of this subsec-
23 tion, no action shall be taken by any bank with respect to any
24 member pursuant to any of the foregoing provisions of this
25 subsection if the effect of such action would be to cause the

1 aggregate outstanding advances, within the meaning of the
2 last sentence to subsection (c) of section 1430 of this Act or
3 within the meaning of regulations of said Board defining said
4 term for the purposes of this sentence, made by such bank to
5 such member to exceed twenty times the amounts paid in by
6 such member for outstanding capital stock held by such
7 member."

8 SEC. 507. Section 8a of the Federal Home Loan Bank
9 Act (12 U.S.C. 1428a) is amended by striking the fifth sen-
10 tence thereof and adding in lieu thereof the following: "Sub-
11 ject to the provisions of section 7 of the Federal Advisory
12 Committee Act, all members and alternates of the Council
13 may be compensated and shall be entitled to reimbursement
14 from the Board for traveling expenses incurred in attendance
15 at meetings of such Council."

16 SEC. 508. (a) Section 6(i) of the Federal Home Loan
17 Bank Act (12 U.S.C. 1426(i)) is amended by striking the
18 period at the end of the second sentence and adding the fol-
19 lowing: "*Provided, however,* That in the case of a voluntary
20 withdrawal, such liquidation shall be deemed a prepayment of
21 any such indebtedness, and shall be subject to any penalties
22 applicable to such prepayment."

23 (b) Section 6 of the Federal Home Loan Act (12 U.S.C.
24 1426) is amended by adding a new subsection (m), to read as
25 follows:

1 “(m) Notwithstanding any other provision of this Act (1)
2 no Federal Home Loan Bank member institution that with-
3 draws from membership may acquire membership in any
4 Federal Home Loan Bank thereafter, except where a transfer
5 of membership between Banks is involved, or in consequence
6 of obtaining insurance of accounts from the Federal Savings
7 and Loan Insurance Corporation, and (2) no institution eligi-
8 ble for such Federal Home Loan Bank membership may
9 obtain such membership in consequence of an application for
10 such membership filed after December 31, 1987, or five
11 years after the date of the granting of the institution’s origi-
12 nal charter, whichever is later, except in consequence of ob-
13 taining insurance of accounts from the Federal Savings and
14 Loan Insurance Corporation. The Board may provide a rea-
15 sonable extension of time, not to exceed two years, beyond
16 the deadlines imposed by this subsection, to allow a rejected
17 applicant which filed in good faith and pursued its applica-
18 tions with diligence, to file a second application.”.

○

97TH CONGRESS
1ST SESSION

S. 1720

To enhance the competitiveness of depository institutions, to expand the range of services provided by such institutions, to protect depositors and creditors of such institutions, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 7, 1981

Mr. GAEN introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To enhance the competitiveness of depository institutions, to expand the range of services provided by such institutions, to protect depositors and creditors of such institutions, and for other purposes.

- 1 *Be it enacted by the Senate and House of Representa-*
- 2 *tives of the United States of America in Congress assembled,*
- 3 That this Act may be cited as the "Financial Institutions
- 4 Restructuring and Services Act of 1981".

1 **TITLE I—DEPOSITORY INSTITUTIONS**2 **INSURANCE AND SERVICES**3 **SHORT TITLE**

4 **SEC. 101.** This title may be cited as the “Depository
5 Institutions Insurance and Services Act of 1981”.

6 **PART A—FORM OF CHARTER; DEMAND ACCOUNTS**7 **CHARTERING AND PURPOSE**

8 **SEC. 111.** Section 5(a) of the Home Owners’ Loan Act
9 of 1933 (12 U.S.C. 1464(a)) is amended to read as follows:

10 “SEC. 5. (a) In order to provide thrift institutions for the
11 deposit or investment of funds and for the extension of credit
12 for homes and other goods and services, the Board is author-
13 ized, under such rules and regulations as it may prescribe, to
14 provide for the organization, incorporation, examination, op-
15 eration, and regulation of associations to be known as Feder-
16 al savings and loan associations, or Federal savings banks,
17 and to issue charters therefor, giving primary consideration
18 to the best practices of thrift institutions in the United
19 States.”.

20 **DEMAND ACCOUNTS AND CAPITAL STOCK**

21 **SEC. 112.** Paragraphs (1) and (2) of section 5(b) of the
22 Home Owners’ Loan Act of 1933 (12 U.S.C. 1464(b)) are
23 amended to read as follows:

24 “(1) An association may raise capital in the form of such
25 savings deposits, shares, or other accounts, for fixed, mini-

1 mum, or indefinite periods of time (all of which are referred
2 to in this section as savings accounts), or in the form of such
3 demand accounts, as are authorized by its charter or by regu-
4 lations of the Board, and may issue such passbooks, time
5 certificates of deposit, or other evidence of accounts as are so
6 authorized. All savings accounts and demand accounts shall
7 have the same priority upon liquidation. Holders of accounts
8 and obligors of an association shall, to such extent as may be
9 provided by its charter or by regulations of the Board, be
10 members of the association, and shall have such voting rights
11 and such other rights as are thereby provided. Except as may
12 be otherwise authorized by the association's charter or regu-
13 lation of the Board in the case of savings accounts for fixed
14 or minimum terms of not less than fourteen days, the pay-
15 ment of any savings account shall be subject to the right of
16 the association to require such advance notice, not less than
17 fourteen days, as shall be provided for by the charter of the
18 association or the regulations of the Board. The payment of
19 withdrawals from accounts in the event an association does
20 not pay all withdrawals in full (subject to the right of the
21 association, where applicable, to require notice) shall be sub-
22 ject to such rules and procedures as may be prescribed by the
23 association's charter or by regulation of the Board, but any
24 association which, except as authorized in writing by the
25 Board, fails to make full payment of any withdrawal when

1 due shall be deemed to be in an unsafe or unsound condition
-2 to transact business within the meaning of subsection (d) of
3 this section. Accounts may be subject to check or to with-
4 drawal or transfer on negotiable or transferable or other
5 order or authorization to the association, as the Board may
6 by regulation provide. Notwithstanding any limitation of this
7 section, associations may establish remote service units for
8 the purpose of crediting savings or demand accounts, debiting
9 such accounts, crediting payments on loans, and the disposi-
10 tion of related financial transactions, as provided in regula-
11 tions prescribed by the Board.

12 “(2) To such extent as the Board may authorize by reg-
13 ulation or advice in writing, an association may borrow, may
14 give security, may be surety as defined by the Board and
15 may issue such notes, bonds, debentures, or other obligations,
16 or other securities, including capital stock, as the Board may
17 so authorize.”.

18 CONVERSIONS TO FEDERAL CHARTERS

19 SEC. 113. Section 5(i) of the Home Owners' Loan Act
20 of 1933 (12 U.S.C. 1464(i)) is amended to read as follows:

21 “(i)(1) Any institution which is, or is eligible to become,
22 a member of a Federal home loan bank may convert itself
23 into a Federal savings and loan association or Federal sav-
24 ings bank under this Act (and in so doing may change direct-
25 ly from the mutual form to the stock form, or from the stock

1 form to the mutual form), but such conversion shall be subject
2 to such rules and regulations as the Board shall prescribe,
3 and thereafter the converted association shall be entitled to
4 all the benefits of this section and shall be subject to exami-
5 nation and regulation to the same extent as other associ-
6 ations incorporated pursuant to this Act.

7 “(2) Subject to the rules and regulations of the Board,
8 any Federal association may convert itself from the mutual
9 form to the stock form of organization, or from the stock form
10 to the mutual form, and any Federal association may change
11 its designation from a Federal savings and loan association to
12 a Federal savings bank, or the reverse.

13 “(3) Any Federal association may convert itself into a
14 savings and loan or savings bank type of institution organized
15 pursuant to the laws of the State, district, commonwealth, or
16 territory (hereinafter referred to in this section as the ‘State’)
17 in which the principal office of such Federal association is
18 located if—

19 “(A) the State permits the conversion of any sav-
20 ings and loan or savings bank type of institution of
21 such State into a Federal association;

22 “(B) such conversion of a Federal association into
23 such a State institution is determined upon the vote in
24 favor of such conversion cast in person or by proxy at
25 a special meeting of members or stockholders called to

1 consider such action, specified by the law of the State
2 in which the home office of the Federal association is
3 located, as required by such law for a State-chartered
4 institution to convert itself into a Federal association,
5 but in no event upon a vote of less than 51 per centum
6 of all the votes cast at such meeting, and upon compli-
7 ance with other requirements reciprocally equivalent to
8 the requirements of such State law for the conversion
9 of a State-chartered institution into a Federal associ-
10 ation;

11 “(C) notice of the meeting to vote on conversion
12 shall be given as herein provided and no other notice
13 thereof shall be necessary; the notice shall expressly
14 state that such meeting is called to vote thereon, as
15 well as the time and place thereof, and such notice
16 shall be mailed, postage prepaid, at least thirty and not
17 more than sixty days prior to the date of the meeting,
18 to each member or stockholder of record of the Federal
19 association at his last address as shown on the books
20 of the Federal association and to the General Counsel
21 of the Federal Home Loan Bank Board, Washington,
22 District of Columbia;

23 “(D) in the event of dissolution of a mutual asso-
24 ciation after conversion, the members or shareholders
25 of the association will share on a mutual basis in the

1 assets of the association in exact proportion to their
2 relative share or account credits;

3 “(E) in the event of dissolution of a stock associ-
4 ation after conversion, the stockholders will share on a
5 equitable basis in the assets of the association; and

6 “(F) such conversion shall be effective upon the
7 date that all the provisions of this Act shall have been
8 fully complied with and upon the issuance of a new
9 charter by the State wherein the association is located.

10 The act of conversion constitutes consent by the institution to
11 be bound by all the requirements that the Federal Savings
12 and Loan Insurance Corporation may legally impose under
13 section 403 of the National Housing Act. The association
14 shall upon conversion and thereafter be authorized to issue
15 securities in any form currently approved at the time of issue
16 by the Federal Savings and Loan Insurance Corporation for
17 issuance by similar insured institutions in such State. If the
18 insurance of accounts is terminated in connection with such
19 conversion, the notice and other action shall be taken as pro-
20 vided by law and regulations for the termination of insurance
21 of accounts.

22 “(4) Any aggrieved person may obtain review of a final
23 action of the Board or the Federal Savings and Loan Insur-
24 ance Corporation which approves, with or without conditions,
25 or disapproves a plan of conversion from the mutual to the

1 stock form, only by complying with the provisions of subsec-
2 tion (k) of section 408 of the National Housing Act within the
3 time limit and in the manner therein prescribed, which provi-
4 sions shall apply in all respects as if such final action were an
5 order the review of which is therein provided for, except that
6 such time limit shall commence upon publication of notice of
7 such final action in the Federal Register or upon the giving of
8 such general notice of final action as is required by or ap-
9 proved under regulations of the Corporation, whichever is
10 later.

11 “(5) To the extent authorized by the Board—

12 “(A) any Federal savings bank chartered as such
13 prior to the enactment of this paragraph may continue
14 to make any investment or engage in any activity not
15 otherwise authorized under this section, to the degree
16 it was permitted to do so as a Federal savings bank
17 prior to such enactment; and

18 “(B) any Federal savings bank formerly organized
19 as a mutual savings bank under State law may contin-
20 ue to make any investment or engage in any activity
21 not otherwise authorized under this section, to the
22 degree it was authorized to do so as a mutual savings
23 bank under State law.

24 The authority conferred by this paragraph may be utilized by
25 any Federal association that acquires, by merger or consoli-

1 dation, a Federal savings bank enjoying grandfathered rights
2 hereunder.”.

3 **CONVERSION FROM STATE MUTUAL TO STATE STOCK**

4 **SEC. 114.** Section 402(j) of the National Housing Act
5 (12 U.S.C. 1725(j)) is amended—

6 (1) by amending paragraph (1) to read as follows:

7 “(1) Except as provided in section 5 of the Home
8 Owners’ Loan Act of 1933, no insured institution may con-
9 vert from the mutual to the stock form except in accordance
10 with the rules and regulations of the Corporation.”; and

11 (2) by striking out paragraphs (2), (3), (5), and (6)
12 and redesignating paragraph (4) as paragraph (2).

13 **TECHNICAL AMENDMENTS**

14 **SEC. 115.** (a) Section 2(d) of the Home Owners’ Loan
15 Act of 1933 (12 U.S.C. 1462(d)) is amended by striking out
16 “mutual” wherever it appears.

17 (b) Section 403(a) of the National Housing Act (12
18 U.S.C. 1726(a)) is amended by striking out “mutual”.

19 (c) Section 408(a)(1)(A) of the National Housing Act (12
20 U.S.C. 1730a(a)(1)(A)) is amended to read as follows:

21 “(A) ‘insured institution’ means a Federal savings
22 and loan association, a Federal savings bank, or a
23 building and loan, savings and loan, or homestead as-
24 sociation, or a cooperative bank, the accounts of which

1 are insured by the Federal Savings and Loan Insur-
2 ance Corporation;”.

3 **PART B—INVESTMENTS**
4 **OVERDRAFTS**

5 **SEC. 121.** Section 5(c)(1)(A) of the Home Owners’ Loan
6 Act of 1933 (12 U.S.C. 1464(c)(1)(A)) is amended to read as
7 follows:

8 “(A) **ACCOUNT LOANS.**—Loans on the security of
9 its savings accounts and loans specifically related to
10 transaction accounts.”.

11 **REAL ESTATE LOANS**

12 **SEC. 122.** Section 5(c)(1)(B) of the Home Owners’ Loan
13 Act of 1933 (12 U.S.C. 1464(c)(1)(B)) is amended to read as
14 follows:

15 “(B) **REAL PROPERTY LOANS.**—Loans on the se-
16 curity of liens upon residential or nonresidential real
17 property.”.

18 **TIME DEPOSITS**

19 **SEC. 123.** Section 5(c)(1)(G) of the Home Owners’ Loan
20 Act of 1933 (12 U.S.C. 1464(c)(1)(G)) is amended to read as
21 follows:

22 “(G) **DEPOSITS.**—Investments in the time depos-
23 its, certificates, or accounts of any bank the deposits of
24 which are insured by the Federal Deposit Insurance
25 Corporation, or in the savings accounts, certificates, or

1 other accounts of any institution the accounts of which
2 are insured by the Federal Savings and Loan Insur-
3 ance Corporation.”.

4 **GOVERNMENT SECURITIES**

5 **SEC. 124.** Section 5(c)(1)(H) of the Home Owners’ Loan
6 Act of 1933 (12 U.S.C. 1464(c)(1)(H)) is amended to read as
7 follows:

8 “(H) **STATE SECURITIES.**—Investments in obli-
9 gations of, or issued by, any State or political subdivi-
10 sion thereof (including any agency, corporation, or in-
11 strumentality of a State or political subdivision).”.

12 **COMMERCIAL AND OTHER LOANS**

13 **SEC. 125.** Section 5(c)(1)(L) of the Home Owners’ Loan
14 Act (12 U.S.C. 1464(c)(1)(L)) is amended to read as follows:

15 “(L) **COMMERCIAL AND OTHER LOANS.**—Secured
16 or unsecured loans for commercial, corporate, business,
17 or agricultural purposes. No association may make
18 loans to one borrower under the authority provided by
19 this subparagraph in excess of the amount a national
20 bank having an identical total capital and surplus could
21 lend such borrower.”.

22 **HOUSING AND LAND DEVELOPMENT LOANS**

23 **SEC. 126.** Section 5(c)(1)(O) of the Home Owners’ Loan
24 Act of 1933 (12 U.S.C. 1464(c)(1)(O)) is amended to read as
25 follows:

1 “(O) HOUSING AND LAND AND URBAN DEVELOP-
2 MENT INSURED OR GUARANTEED INVESTMENTS.—
3 Loans (i) secured by mortgages as to which the associ-
4 ation has the benefit of insurance under title X of the
5 National Housing Act or of a commitment or agree-
6 ment for such insurance, or (ii) as to which the associ-
7 ation has the benefit of any guarantee under title IV of
8 the Housing and Urban Development Act of 1968 or
9 under part B of the National Urban Policy and New
10 Community Development Act of 1970 or under section
11 802 of the Housing and Community Development Act
12 of 1974, or of a commitment or agreement therefor.”.

13 CORPORATE SECURITIES

14 SEC. 127. Section 5(c)(1)(P) of the Home Owners' Loan
15 Act of 1933 (12 U.S.C. 1464(c)(1)(P)) is amended to read as
16 follows:

17 “(P) CORPORATE SECURITIES.—An association
18 may invest in, sell or hold commercial paper and cor-
19 porate debt securities, as defined and approved by the
20 Board. No association may make investments under
21 the authority provided by this subparagraph in the
22 paper or securities of one obligor or maker in excess of
23 the amount a national bank having identical total capi-
24 tal and surplus could so invest in the paper or securi-
25 ties of one obligor or maker.”.

1 **INVESTMENT COMPANIES**

2 **SEC. 128.** Section 5(c)(1)(Q) of the Home Owners' Loan
3 Act of 1933 (12 U.S.C. 1464(c)(1)(Q)) is amended to read as
4 follows:

5 “(Q) **INVESTMENT COMPANIES.**—An association
6 may invest in, redeem or hold shares or certificates in
7 any open-end management investment company which
8 is registered with the Securities and Exchange Com-
9 mission under the Investment Company Act of 1940
10 and the portfolio of which is restricted by such man-
11 agement company's investment policy, changeable only
12 if authorized by shareholder vote, primarily to such in-
13 vestments (without regard to any percentage-of-assets
14 restriction applicable to such investment under this
15 subsection) as an association by law or regulation may
16 invest in, sell, redeem, hold, or otherwise deal with.”.

17 **CONSUMER LOANS**

18 **SEC. 129.** Section 5(c)(1) of the Home Owners' Loan
19 Act of 1933 (12 U.S.C. 1464(c)(1)) is amended by adding at
20 the end thereof the following:

21 “(R) **CONSUMER LOANS.**—An association may
22 make secured or unsecured loans for personal, family,
23 or household purposes, and loans reasonably incident to
24 the provision of such credit.”.

1 **ADDITIONAL INVESTMENT AUTHORITIES**

2 **SEC. 130. Section 5(c) of the Home Owners' Loan Act**
3 **of 1933 (12 U.S.C. 1464(c)) is amended—**

4 (1) by striking out paragraph (2);

5 (2) by redesignating paragraph (6) as paragraph
6 (5);

7 (3) by inserting after paragraph (1) a new para-
8 graph as follows:

9 “(2) **INVESTMENTS IN PERSONALTY.**—An associ-
10 ation may invest in tangible personal property, includ-
11 ing, without limitation, vehicles, mobile homes, ma-
12 chinery, equipment, or furniture, and may hold such
13 property for rental or sale, but such investment may
14 not exceed 10 per centum of the assets of the associ-
15 ation.”;

16 (4) in paragraph (3)—

17 (A) by striking out subparagraph (D); and

18 (B) by amending subparagraph (A) to read as
19 follows:

20 “(A) **EDUCATION LOANS.**—Loans made for
21 the payment of educational expenses.”; and

22 (5) in paragraph (4)—

23 (A) by amending subparagraph (B) to read as
24 follows:

1 “(B) SERVICE CORPORATIONS.—Invest-
2 ments in the capital stock, obligations, or other
3 securities of any corporation organized under the
4 laws of the State in which the home office of the
5 association is located, if the entire capital stock of
6 such corporation is available for purchase only by
7 savings and loan associations of that State and by
8 Federal associations having their home offices
9 therein, but no association may make any invest-
10 ment under this subparagraph if its aggregate out-
11 standing investment under this subparagraph
12 would exceed 5 per centum of the assets of the
13 association. An association may make an invest-
14 ment under this subparagraph notwithstanding
15 that the service corporation in which investment
16 is authorized has invested in any other corpora-
17 tion (i) that is not chartered by the State in which
18 the home office of the association is located, or (ii)
19 that has stock available for purchase by entities
20 other than savings and loan associations of that
21 State or by Federal associations having their
22 home offices in such State.”;

23 (B) by amending subparagraph (C) to read as
24 follows:

1 “(C) FOREIGN ASSISTANCE INVEST-
2 MENTS.—Investments in housing project loans
3 having the benefit of any guaranty under section
4 221 of the Foreign Assistance Act of 1961 or
5 loans having the benefit of any guarantee under
6 section 224 of such Act, or any commitment or
7 agreement with respect to such loans made pursu-
8 ant to either of such sections and in the share
9 capital and capital reserve of the Inter-American
10 Savings and Loan Bank. This authority extends
11 to the acquisition, holding and disposition of loans
12 having the benefit of any guaranty under section
13 221 or 222 of such Act as hereafter amended or
14 extended, or of any commitment or agreement for
15 any such guaranty. Investments under this sub-
16 paragraph shall not exceed, in the case of any as-
17 sociation, 1 per centum of the assets of such asso-
18 ciation.”; and

19 (C) by amending subparagraph (D) to read as
20 follows:

21 “(D) SMALL BUSINESS INVESTMENT COM-
22 PANIES.—An association may invest in stock, ob-
23 ligations, or other securities of any small business
24 investment company formed pursuant to section
25 301(d) of the Small Business Investment Act of

1 1958, for the purpose of aiding members of the
 2 Federal Home Loan Bank System, but no associ-
 3 ation may make any investment under this sub-
 4 paragraph if its aggregate outstanding investment
 5 under this subparagraph would exceed 1 per
 6 centum of the assets of such association.”.

7 INCIDENTAL ACTIVITIES

8 SEC. 131. Section 5(c) of the Home Owners' Loan Act
 9 of 1933 (12 U.S.C. 1464(c)) is amended by adding at the end
 10 thereof the following:

11 “(6) INCIDENTAL ACTIVITIES.—An association
 12 may engage in any activity or venture the Board de-
 13 termines to be incidental to the exercise of the authori-
 14 ty conferred by this subsection or by subsection (b).”.

15 LIQUIDITY INVESTMENTS

16 SEC. 132. Section 5A(b)(1)(B) of the Federal Home
 17 Loan Bank Act (12 U.S.C. 1425a(b)(1)(B)) is amended by
 18 striking out “and commercial banks” and inserting in lieu
 19 thereof the following: “, institutions which are, or are eligible
 20 to become, members thereof, and commercial banks”.

21 REGULATORY JURISDICTION

22 SEC. 133. Section 2(c) of the Bank Holding Company
 23 Act of 1956 (12 U.S.C. 1841(c)) is amended by inserting
 24 after “Islands” the following: “, except an institution the ac-

1 counts of which are insured by the Federal Savings and Loan
2 Insurance Corporation,".

3
4 **BRANCHING**

4 SEC. 134. Section 5 of the Home Owners' Loan Act of
5 1933 (12 U.S.C. 1464) is amended by adding at the end
6 thereof the following:

7 "(o) No association may establish, retain, or operate a
8 branch outside the State in which the association has its
9 home office, unless the association qualifies as a domestic
10 building and loan association under section 7701(a)(19) of the
11 Internal Revenue Code or meets the asset composition test
12 imposed by subparagraph (C) of that section on institutions
13 seeking so to qualify. No out-of-State branch so established
14 shall be retained or operated unless the total assets of the
15 association attributable to all branches of the association in
16 that State would qualify the branches as a whole, were they
17 otherwise eligible, for treatment as a domestic building and
18 loan association under said section 7701(a)(19). The limita-
19 tions of this subsection shall not apply if (1) the branch re-
20 sults from a transaction authorized under section 408(n) of
21 the National Housing Act; (2) the branch was authorized for
22 the association prior to the enactment of the Financial Insti-
23 tutions Restructuring and Services Act of 1981; (3) the law
24 of the State in which the branch is or is to be located would
25 permit establishment of the branch were the association an

1 institution of the savings and loan or savings bank type char-
 2 tered by the State in which its home office is located; or (4)
 3 the branch was operated lawfully as a branch under State
 4 law prior to the association's conversion to a Federal charter.
 5 The Board, for good cause shown, may allow associations up
 6 to two years to comply with the requirements of this subsec-
 7 tion."

8 **HOLDING COMPANY ACTIVITIES**

9 **SEC. 135.** Section 408 of the National Housing Act (12
 10 U.S.C. 1730a) is amended by adding at the end thereof the
 11 following:

12 "(m) No savings and loan holding company, nor any
 13 subsidiary thereof which is not an insured institution, whose
 14 subsidiary insured institution fails to qualify as a domestic
 15 building and loan association under section 7701(a)(19) of the
 16 Internal Revenue Code, shall commence, or continue for
 17 more than three years after such failure, any business activity
 18 other than those specified for multiple savings and loan hold-
 19 ing companies and their subsidiaries under subsection (c)(2)
 20 hereof."

21 **PART C—PREEMPTION OF DUE ON SALE PROHIBITIONS**

22 **PREEMPTION**

23 **SEC. 141.** Section 501 of Public Law 96-221 (12
 24 U.S.C. 1735f-7 note) is amended by redesignating subsec-

1 tions (f) and (g) as subsections (g) and (h), respectively, and
2 adding a new subsection (f) to read as follows:

3 “(f)(1) The provisions of the constitution or the laws of
4 any State limiting the ability of a depository institution or a
5 lender approved by the Secretary of Housing and Urban De-
6 velopment for participation in any mortgage insurance pro-
7 gram under the National Housing Act (or their transferees),
8 to enter into contracts, or to enforce contracts, whenever ex-
9 ecuted, providing that the institution may, at its option, de-
10 clare due and payable sums secured by the institution’s or
11 lender’s security instrument if all or any part of the property,
12 or an interest therein, securing the loan is sold or transferred
13 by the borrower without the institution’s or the lender’s (or
14 their transferees’) prior written consent shall not apply to
15 contracts involving loans secured by a lien on residential real
16 property, by a lien on stock allocated to a dwelling unit in a
17 residential cooperative housing corporation, or by a lien on a
18 residential manufactured home. Except as limited by the
19 Federal Home Loan Bank Board pursuant to subsection (g)
20 herein, exercise by the institution or lender (or their transfer-
21 ees) of such option (hereafter referred to as a ‘due-on-sale
22 clause’) shall be exclusively governed by the terms of the
23 loan contract, and all rights and remedies of the institution or
24 lender (or their transferees) and borrower shall be fixed and
25 governed by the contract. In the exercise of its authority

1 under subsection (g), the Board may require institutions and
2 lenders to observe appropriate consumer safeguards to the
3 extent it is authorized to require such observance by Federal
4 savings and loan associations.

5 “(2) Except as provided in paragraph (3), the provisions
6 of paragraph (1) shall not apply in any State after the date
7 (on or after the date of enactment of the Financial Institu-
8 tions Restructuring and Services Act of 1981 and before 3
9 years after such date of enactment) on which such State
10 adopts a law or certifies that the voters of such State have
11 voted in favor of any provision, constitutional or otherwise,
12 which states explicitly and by its terms that such State does
13 not want the provisions of paragraph (1) to apply in such
14 State.

15 “(3) In any case in which a State takes an action de-
16 scribed in paragraph (2), the provisions of paragraph (1) shall
17 continue to apply to a contract involving—

18 “(A) any loan, mortgage, credit sale, or advance
19 which is made after the date such action was taken
20 pursuant to a commitment therefor which was entered
21 during the period beginning on the date of enactment
22 of the Financial Institutions Restructuring and Services
23 Act of 1981, and ending on the date on which such
24 State takes such action; and

1 “(B) any loan, mortgage, or advance which is a
2 rollover of a loan, mortgage, or advance, as described
3 in regulations of the Federal Home Loan Bank Board,
4 which was made or committed to be made during the
5 period beginning on the date of enactment of the Fi-
6 nancial Institutions Restructuring and Services Act of
7 1981, and ending on the date on which such State
8 takes any action described in paragraph (2).”.

9 RULEMAKING

10 SEC. 142. Subsection (g) of section 501 of Public Law
11 96-221 (12 U.S.C. 1735f-7 note) is amended to read as fol-
12 lows:

13 “(g)(1) The Federal Home Loan Bank Board is author-
14 ized to—

15 “(A) issue rules, regulations, interpretations, or
16 approvals governing the implementation of this section;
17 and

18 “(B) delegate authority to duly authorized offi-
19 cials, employees, or agents of the Board, of the Comp-
20 troller of the Currency, or of the National Credit
21 Union Administration Board to issue interpretations of
22 approvals governing the implementation of this section.

23 “(2) No provision of the constitution or laws of any
24 State imposing any liability, penalty, or forfeiture shall apply
25 to any act done or omitted in good faith in conformity with

1 any rule, regulation, interpretation, or approval under this
 2 section by the Federal Home Loan Bank Board or in con-
 3 formity with any interpretation or approval by an official,
 4 employee, or agent of the Board, or of the Comptroller of the
 5 Currency, or of the National Credit Union Administration
 6 Board duly authorized by the Board to issue interpretations
 7 or approvals under this section under such procedures as the
 8 Board may prescribe therefor, notwithstanding that, after
 9 such act or omission has occurred, such rule, regulation, or
 10 approval is amended, rescinded, or determined by judicial or
 11 other authority to be invalid for any reason.”.

12 **EFFECTIVE DATE**

13 **SEC. 143.** Subsection (h) of section 501 of Public Law
 14 96-221 (12 U.S.C. 1735f-7 note) is amended by inserting
 15 before the period the following: “, except for subsection (f)”.

16 **PART D—EXTRAORDINARY AUTHORITY RELATING TO**

17 **THRIFTS**

18 **EMERGENCY THRIFT ACQUISITIONS**

19 **SEC. 151.** (a) Section 408 of the National Housing Act
 20 (12 U.S.C. 1730a) (as amended by section 135) is amended
 21 by adding at the end thereof the following:

22 “(n) Notwithstanding any other provision of State or
 23 Federal law, except as provided in subsections (e)(2) and (f)
 24 hereof, and in the third sentence of this subsection, the Cor-
 25 poration, upon its determination that severe financial condi-

1 tions exist which threaten the stability of a significant
2 number of insured institutions, or of insured institutions pos-
3 sessing significant financial resources, may authorize, in its
4 discretion and where it determines such authorization would
5 lessen the risk to the Corporation, an insured institution that
6 is eligible for assistance pursuant to section 406(f) of this Act
7 to merge or consolidate with, or to transfer its assets and
8 liabilities to, any other insured institution or any insured bank
9 (as that term insured bank is defined in section 3(h) of the
10 Federal Deposit Insurance Act (12 U.S.C. 1813(h)), may au-
11 thorize any other insured institution to acquire control of said
12 insured institution, or may authorize any company to acquire
13 control of said insured institution or to acquire the assets or
14 assume the liabilities thereof. Mergers, consolidations, trans-
15 fers, and acquisitions under this subsection shall be on such
16 terms as the Corporation shall provide. Where otherwise re-
17 quired by law, transactions under this subsection must be ap-
18 proved by the primary Federal supervisor of the party there-
19 to that is not an insured institution. In considering authoriza-
20 tions under this subsection, the need to minimize financial
21 assistance required of the Corporation shall be the paramount
22 consideration, but the Corporation shall make a reasonable
23 effort to authorize transactions under this subsection in the
24 following sequence: First, between institutions of the same
25 type within the same State; second, between institutions of

1 the same type in different States; third, between institutions
2 of different types in the same State; and fourth, between in-
3 stitutions of different types in different States. As used
4 herein, the term 'type' shall refer to the purpose of the orga-
5 nizations and the general nature of their powers rather than
6 to the identity of the charterers or their form of corporate
7 organization."

8 (b) Section 4(c)(8) of the Bank Holding Company Act of
9 1956 (12 U.S.C. 1843(c)(8)) is amended by adding at the end
10 thereof the following: "Notwithstanding any other provision
11 of this Act, if the Board finds that an emergency exists which
12 requires it to act immediately on any application under this
13 subsection involving a thrift institution, and the primary Fed-
14 eral regulator of such institution concurs in said finding, the
15 Board may dispense with the notice and hearing requirement
16 of this subsection and the Board may approve or deny any
17 such application without notice or hearing."

18 CONFORMING AMENDMENT

19 SEC. 152. Section 408(e)(2) of the National Housing
20 Act (12 U.S.C. 1730a(e)(2)) is amended—

21 (1) by inserting after "subsection" in the first sen-
22 tence the following: ", or any transaction under sub-
23 section (n) hereof,"; and

1 (2) by inserting after "acquisition," in the third
2 sentence the following: "except a transaction under
3 subsection (n) hereof,".

4 **EMERGENCY STOCK CHARTERS**

5 **SEC. 153. (a)** Section 5 of the Home Owners' Loan Act
6 of 1933 (12 U.S.C. 1464) (as amended by section 134) is
7 amended by adding at the end thereof the following:

8 “(p) Notwithstanding any other provision of this section
9 or State law, and consistent with the purposes of this Act,
10 the Board may authorize (or in the case of a Federal associ-
11 ation, require) the conversion of a mutual savings and loan
12 association or mutual savings bank into a Federal stock sav-
13 ings and loan association or Federal stock savings bank, or
14 charter a Federal stock savings and loan association or Fed-
15 eral stock savings bank to acquire the assets of, or merge
16 with such a mutual institution under the rules and regulations
17 of the Board. The Board may condition its approval of the
18 conversion or acquisition of a mutual savings bank under this
19 subsection that was previously insured by the Federal Depos-
20 it Insurance Corporation upon the receipt from the Federal
21 Deposit Insurance Corporation of reasonable indemnification
22 of the Federal Savings and Loan Insurance Corporation for
23 losses that may be incurred by the latter as a consequence of
24 its insuring the accounts of such institution, as agreed to by
25 the Corporations, and the Federal Deposit Insurance Corpo-

1 ration is authorized to pay such indemnification, without
2 regard to any other provision of law. Authorizations under
3 this subsection may be made only to assist an institution in
4 receivership, or if the primary Federal supervisor has deter-
5 mined that severe financial conditions exist which threaten
6 the stability of an institution and that such authorization is
7 likely to improve the financial condition of the institution, or
8 when either of the Corporations has contracted to provide
9 assistance to such institution under section 406 of the Na-
10 tional Housing Act or section 13 of the Federal Deposit In-
11 surance Act.”.

12 (b) Section 2(i) of the Bank Holding Company Act (12
13 U.S.C. 1841(i)) is amended by adding after the word
14 “shares” the following: “or, (4) a Federal stock savings bank
15 or savings and loan association organized under section 5(p)
16 of the Home Owners’ Loan Act of 1933 (12 U.S.C.
17 1464(p))”.

18 ASSISTANCE TO THRIFT INSTITUTIONS

19 SEC. 154. Section 406(f)(2) of the National Housing Act
20 (12 U.S.C. 1729(f)(2)) is amended by adding at the end there-
21 of the following: “The Corporation may provide any party
22 acquiring control of, merging with, consolidating with, or ac-
23 quiring the assets of an insured institution under section
24 408(n) of this Act with such financial assistance as it could
25 provide an insured institution under this subsection.”.

1 **CONSERVATORSHIP AND RECEIVERSHIP**

2 **SEC. 155. (a)** Section 406(a) of the National Housing
3 Act (12 U.S.C. 1729(a)) is amended by striking out “savings
4 and loan”.

5 **(b)** Section 406(b) of the National Housing Act (12
6 U.S.C. 1729(b)) is amended to read as follows:

7 “(b) In the event that a Federal association is in default,
8 the Corporation shall be appointed as conservator or receiver
9 and as such (1) is authorized (A) to take over the assets of
10 and operate such association, (B) to take such action as may
11 be necessary to put it in a sound and solvent condition, (C) to
12 merge it with another insured institution, (D) to organize a
13 new Federal association to take over its assets, (E) to pro-
14 ceed to liquidate its assets in an orderly manner, or (F) to
15 make such other disposition of the matter as it deems to be in
16 the best interest of the association, its savers, and the Corpo-
17 ration, and (2) shall pay all valid credit obligations of the
18 association. The Corporation shall pay insurance as provided
19 in section 405. The surrender and transfer to the Corporation
20 of an insured account in any such association which is in
21 default shall subrogate the Corporation with respect to such
22 insured account, but shall not affect any right which the in-
23 sured member may have in the uninsured portion of his ac-
24 count or any right which he may have to participate in the

1 distribution of the net proceeds remaining from the disposi-
2 tion of the assets of such association.”.

3 (c) Section 406(c) of the National Housing Act (12
4 U.S.C 1729(c)) is amended by striking the phrase “savings
5 and loan” wherever it appears.

6 (d) Section 406(c)(1) of the National Housing Act (12
7 U.S.C. 1729(c)(1)) is amended by inserting “(A)” after
8 “(c)(1)” and by adding at the end thereof the following:

9 “(B) Notwithstanding any provision of State law, or of
10 this section, in the event the Federal Home Loan Bank
11 Board determines that any of the grounds specified in section
12 5(d)(6)(A) (i), (ii), or (iii) of the Home Owners’ Loan Act of
13 1933 exist with respect to an insured institution, other than a
14 Federal association, the Board shall have exclusive power
15 and jurisdiction to appoint the Corporation as sole conserva-
16 tor or receiver of such institution. In such cases the Corpora-
17 tion shall have the same powers and duties with respect to
18 insured institutions as are conferred upon it under subsection
19 (b) of this section with respect to Federal associations.”.

20 (e) Section 406(c)(2) of the National Housing Act (12
21 U.S.C. 1729(c)(2)) is amended by inserting “conservator or”
22 immediately after “sole” in the first sentence.

23 (f) Section 406(c)(3) of the National Housing Act (12
24 U.S.C. 1729(c)(3)) is amended—

1 (1) by inserting "conservator or" immediately
2 prior to the word "receiver" wherever it appears
3 therein;

4 (2) by striking out "paragraph (2)" and inserting
5 in lieu thereof "paragraph (1) or (2)"; and

6 (3) by striking out the second sentence.

7 (g) Section 406(d) of the National Housing Act (12
8 U.S.C. 1729(d)) is amended to read as follows:

9 "(d) In connection with the liquidation of insured institu-
10 tions, the Corporation shall have power to carry on the busi-
11 ness of and to collect all obligations to the insured institu-
12 tions, to settle, compromise, or release claims in favor of or
13 against the insured institutions, and to do all other things
14 that may be necessary in connection therewith, subject only
15 to the regulation of the Federal Home Loan Bank Board, or,
16 in cases where the Corporation has been appointed conserva-
17 tor, receiver, or legal custodian solely by a public authority
18 having jurisdiction over the matter other than said Board,
19 subject only to the regulation of such public authority."

20 **ASSISTANCE TO HOME LOAN BANK MEMBERS**

21 SEC. 156. Section 16 of the Federal Home Loan Bank
22 Act (12 U.S.C. 1436) is amended by inserting "(a)" after
23 "SEC. 16." and adding at the end thereof the following:

24 "(b) Notwithstanding subsection (a) or any other provi-
25 sion of this Act, if the Board determines that severe financial

1 conditions exist threatening the stability of member institu-
 2 tions, it may suspend temporarily the requirements under
 3 subsection (a) that a portion of net earnings be set aside semi-
 4 annually by each Federal Home Loan Bank to a reserve ac-
 5 count and permit each Federal Home Loan Bank to declare
 6 and pay dividends out of undivided profits. Thereafter, divi-
 7 dends shall be paid in accordance with subsection (a).”.

8 **BORROWING AUTHORITY**

9 **SEC. 157. (a)** Section 402(d) of the National Housing
 10 Act (12 U.S.C. 1725(d)) is amended by inserting before the
 11 period at the end of the first sentence the following: “, except
 12 that interest on loans from the Federal Home Loan Banks
 13 shall be not less than their current marginal cost of funds,
 14 taking into account the maturities involved, and loans from
 15 the Federal Home Loan Banks shall be adequately secured,
 16 as determined by the Federal Home Loan Bank Board”.

17 **(b)** Section 402(i) of the National Housing Act (12
 18 U.S.C. 1725(i)) is amended—

19 (1) in the first sentence, after the word “source”
 20 by inserting the following: “, except the Federal Home
 21 Loan Banks”; and

22 (2) in the first sentence, after the first place the
 23 word “loan” appears subsequent to the first colon, by
 24 inserting “from the Treasury”.

1 (c) Section 11 of the Federal Home Loan Bank Act (12
2- U.S.C. 1431) is amended by adding at the end thereof the
3 following:

4 “(k) The Federal Home Loan Banks are authorized to
5 make loans to the Federal Savings and Loan Insurance Cor-
6 poration, as directed by the Board, but subject to section
7 402(d) of the National Housing Act.”.

8 **SECONDARY INSURANCE RESERVE**

9 **SEC. 158.** Section 404 of the National Housing Act (12
10 U.S.C. 1727) is amended by redesignating subsection (h) as
11 subsection (i) and by inserting after subsection (g) the follow-
12 ing:

13 “(h) Notwithstanding any other provision of this section,
14 the Corporation, upon its determination that extraordinary
15 financial conditions exist increasing the risk to the Corpora-
16 tion, may terminate distribution of shares of the secondary
17 reserve and utilize said reserve on the same basis as the pri-
18 mary reserve. If otherwise authorized, the Corporation may
19 resume such distribution upon its determination that said con-
20 ditions no longer exist.”.

21 **PART E—EXTRAORDINARY AUTHORITY RELATING TO**
22 **BANKS**

23 **ASSISTANCE TO INSURED BANKS**

24 **SEC. 161.** Section 13(c) of the Federal Deposit Insur-
25 ance Act (12 U.S.C. 1823(c)) is amended to read as follows:

1 “(c)(1) In order to reopen a closed insured bank or,
2 when the Corporation has determined that an insured bank is
3 in danger of closing, in order to prevent such closing, the
4 Corporation, in the discretion of its Board of Directors, is
5 authorized to make loans to, or purchase the assets of, or
6 make deposits in, such insured bank, upon such terms and
7 conditions as the Board of Directors may prescribe, when in
8 the opinion of the Board of Directors the continued operation
9 of the bank is essential to provide adequate banking service
10 in the community.

11 “(2) Whenever severe financial conditions exist which
12 threaten the stability of a significant number of insured
13 banks, the Corporation, in the discretion of its Board of Di-
14 rectors, is authorized to make loans to, or purchase the assets
15 of, or make deposits in, any insured bank so threatened, upon
16 such terms and conditions as the Board of Directors may
17 prescribe, if it is probable such action will substantially
18 reduce the risk of loss or avert a threatened loss to the Cor-
19 poration.

20 “(3) Any loans and deposits made pursuant to the provi-
21 sions of this paragraph may be in subordination to the rights
22 of depositors and other creditors.”.

1 LOANS TO INSURED BANKS

2 SEC. 162. The first paragraph of section 13(e) of the
3 Federal Deposit Insurance Act (12 U.S.C. 1823(e)) is
4 amended to read as follows:

5 "Whenever in the judgment of the Board of Directors
6 such action will reduce the risk of loss or avert a threatened
7 loss to the Corporation and will facilitate a merger or consoli-
8 dation of an insured bank with another institution or will fa-
9 cilitate the sale of the assets of an open or closed insured
10 bank to and assumption of its liabilities by another institution,
11 the Corporation may, upon such terms and conditions as it
12 may determine, make loans secured in whole or in part by
13 assets of an open or closed insured bank, which loans may be
14 in subordination to the rights of depositors and other credi-
15 tors, or the Corporation may purchase any such assets or
16 may guarantee any other institution against loss by reason of
17 its assuming the liabilities and purchasing the assets of an
18 open or closed insured bank. Any insured national bank or
19 District bank, or the Corporation as receiver thereof, is au-
20 thorized to contract for such sales or loans and to pledge any
21 assets of the bank to secure such loans. As used in this sub-
22 section, the term 'institution' means an insured bank or an
23 association or bank insured by the Federal Savings and Loan
24 Insurance Corporation."

1 **CONVERSION OF MUTUAL SAVINGS BANKS**

2 **SEC. 163. (a)** Section 26 of the Federal Deposit Insur-
3 **ance Act (12 U.S.C. 1831c)** is amended by inserting “(a)”
4 immediately after “Sec. 26.”; by inserting “mutual” after
5 the word “Federal” the first two times it appears; and by
6 striking out “or a savings bank which is (or within sixty days
7 after the merger or consolidation becomes) an insured institu-
8 tion within the meaning of section 401 of the National Hous-
9 ing Act”.

10 **(b)** Section 26 of the Federal Deposit Insurance Act (12
11 U.S.C. 1831c) is amended by adding at the end thereof the
12 following new subsection:

13 “(b) Whenever, pursuant to section 5(p) of the Home
14 Owners’ Loan Act of 1933, a State-chartered insured mutual
15 savings bank converts into a Federal stock savings bank or
16 merges with or is acquired by a Federal stock savings bank,
17 the Corporation, in the discretion of its Board of Directors,
18 may provide reasonable indemnification to the Federal Sav-
19 ings and Loan Insurance Corporation, as agreed to by the
20 two corporations, for losses that may be incurred by the
21 latter as a consequence of the Federal Savings and Loan In-
22 surance Corporation insuring the accounts of such institu-
23 tion.”.

1 **FEDERAL DEPOSIT INSURANCE CORPORATION**

2 **ASSESSMENTS**

3 **SEC. 164.** The third sentence of section 7(d)(1) of the
4 Federal Deposit Insurance Act (12 U.S.C. 1817(d)(1)) is
5 amended—

6 (1) by striking out “and” the second place it ap-
7 pears; and

8 (2) by inserting before the period at the end there-
9 of the following: “; and (4) any lending costs for the
10 calendar year, which shall be the difference between
11 the rate of interest earned, if any, from each loan made
12 by the Corporation pursuant to section 13 after Janu-
13 ary 1, 1981, and the Corporation’s average investment
14 portfolio yield for the calendar year”.

15 **EXTRAORDINARY BANK ACQUISITIONS**

16 **SEC. 165.** Subsection (e) of section 13 of the Federal
17 Deposit Insurance Act (12 U.S.C. 1823(e)) is amended—

18 (1) by redesignating the first paragraph as
19 “13(e)(1)” and the second paragraph as “13(h)”; and

20 (2) by adding the following new paragraph as
21 “13(e)(2)”:

22 “(2)(A) Whenever an insured bank that had total assets
23 equal to or greater than 0.12 per centum of aggregate assets
24 in domestic (United States) offices of insured banks (as deter-
25 mined from the most recently compiled Reports of Condition

1 filed by insured banks) is closed and the Corporation is ap-
2 pointed receiver, then, the receiver may, in its discretion and
3 upon such terms and conditions as it may determine, and
4 with such approvals as may elsewhere be required by any
5 State or Federal courts and supervisory agencies, sell assets
6 of the closed bank to and arrange for the assumption of the
7 liabilities of the closed bank by an insured depository institu-
8 tion located in the same State as that in which the closed
9 bank was chartered but owned by an out-of-State bank or
10 bank holding company. Notwithstanding subsection (d) of
11 section 3 of the Bank Holding Company Act of 1956 or any
12 other provision of State or Federal law, the acquiring institu-
13 tion is authorized to be and shall be operated as a subsidiary
14 of the out-of-State bank or bank holding company, except
15 that an insured bank may operate the assuming institution as
16 a subsidiary only if specifically authorized by law other than
17 this paragraph.

18 “(B) In determining whether to arrange a sale of assets
19 and assumption of liabilities of a closed insured bank under
20 the authority of this paragraph (2), the receiver may solicit
21 such offers as is practicable from any prospective purchasers
22 it determines, in its sole discretion, are both qualified and
23 capable of acquiring the assets and the liabilities of the closed
24 bank.

1 “(C) If, after receiving offers, the highest acceptable
2 offer is from a subsidiary of an out-of-State bank or bank
3 holding company, the receiver shall permit the highest ac-
4 ceptable offeror among any existing in-State insured deposi-
5 tory institutions and subsidiaries of in-State bank holding
6 companies to submit a new offer for the assets and liabilities
7 of the closed bank. If the in-State institution reoffers a great-
8 er amount than the previous highest acceptable offer, then
9 the receiver shall sell the assets and transfer the liabilities of
10 the closed bank to that institution.

11 “(D) If there is no acceptable offer received from an
12 existing in-State depository institution or subsidiary of an in-
13 State bank holding company, or if there is no reoffer greater
14 than the highest acceptable offer, then the receiver shall
15 permit the highest acceptable offeror of the subsidiaries of the
16 insured banks chartered in States adjoining the State in
17 which the closed bank was chartered and bank holding com-
18 panies whose banking subsidiaries’ operations are principally
19 conducted in States adjoining the State in which the closed
20 bank was chartered (if its offer was not the highest received
21 by the receiver) to make a new offer for the assets and liabil-
22 ities of the closed bank. If this subsidiary reoffers a greater
23 amount than the previous highest acceptable offer than the
24 receiver shall sell the assets and transfer the liabilities of the
25 closed bank to that institution.

1 “(E) If no offer under subparagraph (C) or (D) is re-
2 ceived which exceeds the original highest acceptable offer,
3 then the receiver shall sell the assets and transfer the liabil-
4 ities of the closed bank to the highest acceptable offeror.

5 “(F) In making a determination to solicit offers under
6 subparagraph (B), the State bank supervisor of the State in
7 which the closed insured bank was chartered shall be consult-
8 ed. The State bank supervisor shall be given a reasonable
9 opportunity, and in no instance a period of less than twenty-
10 four hours, to object to the use of the provisions of this para-
11 graph. If the State supervisor objects, the receiver may use
12 the authority of this paragraph only by a unanimous vote of
13 the Board of Directors. The Board of Directors shall provide
14 to the State supervisor, as soon as practicable, a written cer-
15 tification of its determination.

16 “(G) The receiver shall not make any sale under the
17 provisions of this paragraph—

18 “(i) which would result in a monopoly, or which
19 would be in furtherance of any combination or conspir-
20 acy to monopolize or to attempt to monopolize the
21 business of banking in any part of the United States;
22 or

23 “(ii) whose effect in any section of the country
24 may be substantially to lessen competition, or to tend

1 to create a monopoly, or which in any other manner
2 would be in restraint of trade,
3 unless it finds that the anticompetitive effects of the proposed
4 transaction are clearly outweighed in the public interest by
5 the probable effect of the transaction in meeting the conven-
6 ience and needs of the community to be served.

7 “(H) Nothing contained in this paragraph shall be con-
8 strued to limit the Corporation’s powers in paragraph (1) to
9 assist a transaction under this paragraph.

10 “(I) As used in this paragraph—

11 “(i) the term ‘receiver’ shall mean the Corpora-
12 tion when it has been appointed the receiver of a
13 closed insured bank;

14 “(ii) the term ‘insured depository institution’ shall
15 mean an insured bank or an association or bank in-
16 sured by the Federal Savings and Loan Insurance Cor-
17 poration;

18 “(iii) the term ‘existing in-State insured depository
19 institution’ shall mean an insured depository institution
20 that is chartered in the same State as the State in
21 which the closed bank was chartered;

22 “(iv) the term ‘in-State bank holding company’
23 shall mean a bank holding company whose banking
24 subsidiaries’ operations are principally conducted in the

1 same State as the State in which the closed bank was
2 chartered; and

3 “(v) the term ‘out-of-State bank or bank holding
4 company’ shall mean an insured bank having its princi-
5 pal place of banking business in a State other than the
6 State in which the closed bank was chartered or a
7 bank holding company whose banking subsidiaries’ op-
8 erations are principally conducted in a State other than
9 the State in which the closed bank was chartered.”.

10 PART F—MISCELLANEOUS

11 DELEGATIONS

12 SEC. 171. Section 17(a) of the Federal Home Loan
13 Bank Act (12 U.S.C. 1437(a)) is amended by inserting after
14 the first sentence the following: “Notwithstanding any other
15 provision of law, the Board may from time to time make such
16 provision as it deems appropriate authorizing the perform-
17 ance by any officer, employee, agent, or administrative unit
18 thereof of any function of the Board (including any function of
19 the Federal Savings and Loan Insurance Corporation),
20 except with regard to promulgation of rules and regulations
21 in accordance with the Administrative Procedures Act, and
22 adjudications subject to such Act.”.

23 ATTORNEYS FEES

24 SEC. 172. Section 5(d)(8)(A) of the Home Owners’ Loan
25 Act of 1933 (12 U.S.C. 1464(d)(8)(A)) is amended by insert-

1 ing in the last sentence thereof, after the word "party", the
 2 following: ", which prevails,".

3 **SECONDARY MARKET PURCHASE AUTHORITY**

4 **SEC. 173. (a)** Section 305(a)(1) and (b) of the Federal
 5 Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(1)
 6 and (b)) are amended by inserting "the Federal Deposit In-
 7 surance Corporation, the National Credit Union Administra-
 8 tion," after "Federal Savings and Loan Insurance Corpora-
 9 tion," each place it appears.

10 (b) Section 305(a)(2) of the Federal Home Loan Mort-
 11 gage Corporation Act (12 U.S.C. 1454(a)(2)) is amended by
 12 amending the third sentence to read as follows: "The Corpo-
 13 ration may purchase a conventional mortgage which was
 14 originated more than one year prior to the purchase date only
 15 if the seller is the Federal Deposit Insurance Corporation,
 16 the Federal Savings and Loan Insurance Corporation, the
 17 National Credit Union Administration, or any other sellers
 18 currently engaged in mortgage lending or investing activi-
 19 ties.".

20 (c) The fourth sentence of section 302(b)(2) of the Fed-
 21 eral National Mortgage Association Charter Act (12 U.S.C.
 22 1717(b)(2)) is amended to read as follows: "The corporation
 23 may purchase a conventional mortgage which was originated
 24 more than one year prior to the purchase date only if the
 25 seller is the Federal Deposit Insurance Corporation, the Fed-

1 eral Savings and Loan Insurance Corporation, the National
 2 Credit Union Administration, or any other seller currently
 3 engaged in mortgage lending or investing activities.”.

4 **SECURITY FOR ADVANCES**

5 **SEC. 174.** Section 10 of the Federal Loan Bank Act (12
 6 U.S.C. 1430) is amended—

7 (1) by amending subsection (a) to read as follows:

8 “(a) Each Federal Home Loan Bank is authorized to
 9 make secured advances to its members upon such security as
 10 the Board may prescribe.”;

11 (2) by striking out the first two sentences of sub-
 12 section (b); and

13 (3) by striking out the word “twelve” wherever it
 14 appears in subsection (c) and inserting in lieu thereof
 15 the word “twenty”.

16 **INSURANCE OF ACCOUNTS IN MERGERS**

17 **SEC. 175.** Section 405(a) of the National Housing Act
 18 (12 U.S.C. 1728(a)) is amended by inserting after the first
 19 sentence the following: “Whenever the liabilities of an in-
 20 sured institution for accounts shall have been assumed by
 21 another insured institution or institutions, whether by way of
 22 merger, consolidation, or other statutory assumption, or pur-
 23 suant to contract, all accounts so assumed shall have sepa-
 24 rate insurance which shall terminate at the end of six months
 25 from the date such assumption takes effect or, in the case of

1 any certificate account, the earliest maturity date after the
2 six-month period.”.

3 **DELETION OF OBSOLETE REQUIREMENT**

4 **SEC. 176.** Section 6(c)(2) of the Federal Home Loan
5 Bank Act (12 U.S.C. 1426(c)(2)) is amended to read as fol-
6 lows:

7 “(2) Notwithstanding any other provision of this subsec-
8 tion, no action shall be taken by any bank with respect to any
9 member pursuant to any of the foregoing provisions of this
10 subsection if the effect of such action would be to cause the
11 aggregate outstanding advances, within the meaning of the
12 last sentence of subsection (c) of section 1430 of this Act or
13 within the meaning of regulations of said Board defining said
14 term for the purposes of this sentence, made by such bank to
15 such member to exceed twenty times the amounts paid in by
16 such member for outstanding capital stock held by such
17 member.”.

18 **COMPENSATION OF ADVISORY COMMITTEE MEMBERS**

19 **SEC. 177.** Section 8a of the Federal Home Loan Bank
20 Act (12 U.S.C. 1428a) is amended by striking the fifth sen-
21 tence thereof and adding in lieu thereof the following: “Sub-
22 ject to the provisions of section 7 of the Federal Advisory
23 Committee Act, all members and alternates of the Council
24 may be compensated and shall be entitled to reimbursement

1 from the Board for traveling expenses incurred in attendance
2 at meetings of such Council.”.

3 WITHDRAWAL FROM MEMBERSHIP

4 SEC. 178. (a) Section 6(i) of the Federal Home Loan
5 Bank Act (12 U.S.C. 1426(i)) is amended by inserting before
6 the period at the end of the second sentence the following: “,
7 except that in the case of a voluntary withdrawal, such liqui-
8 dation shall be deemed a prepayment of any such indebted-
9 ness, and shall be subject to any penalties applicable to such
10 prepayment”.

11 (b) Section 6 of the Federal Home Loan Bank Act (12
12 U.S.C. 1426) is amended by adding at the end thereof the
13 following:

14 “(m) Notwithstanding any other provision of this Act,
15 (1) no Federal Home Loan Bank member institution that
16 withdraws from membership may acquire membership in any
17 Federal Home Loan Bank thereafter, except where a transfer
18 of membership between Banks is involved, or in consequence
19 of obtaining insurance of accounts from the Federal Savings
20 and Loan Insurance Corporation, and (2) no institution eligi-
21 ble for such Federal Home Loan Bank membership may
22 obtain such membership in consequence of an application for
23 such membership filed after December 31, 1987, or five
24 years after the date of the granting of the institution’s origi-
25 nal charter, whichever is later, except in consequence of ob-

1 taining insurance of accounts from the Federal Savings and
2 - Loan Insurance Corporation. The Board may provide a rea-
3 sonable extension of time, not to exceed two years, beyond
4 the deadlines imposed by this subsection, to allow a rejected
5 applicant which filed in good faith and pursued its applica-
6 tions with diligence, to file a second application.”.

7 **TITLE II—PROVISIONS RELATING TO NATIONAL**
8 **AND MEMBER BANKS**

9 **PART A—GENERAL PROVISIONS**

10 **LENDING LIMITS**

11 **SEC. 201.** Section 5200 of the Revised Statutes (12
12 U.S.C. 84) is amended to read as follows:

13 “SEC. 5200. (a)(1) The total loans or extensions of
14 credit by a national banking association to a person outstand-
15 ing at one time and not fully secured, as determined in a
16 manner consistent with paragraph (2) of this subsection, by
17 collateral having a market value at least equal to the amount
18 of the loan or extension of credit shall not exceed 15 per
19 centum of the unimpaired capital and unimpaired surplus of
20 the association.

21 “(2) The total loans or extensions of credit by a national
22 banking association to a person outstanding at one time and
23 fully secured by readily marketable collateral having a
24 market value, as determined by reliable price quotations rea-
25 sonably continuously available at least equal to the amount of

1 the association's advance and in accordance with any other
2 rules or regulations established by the Comptroller of the
3 Currency, shall not exceed 10 per centum of the capital and
4 unimpaired surplus of the association. This limitation shall be
5 separate from and in addition to the limitation contained in
6 paragraph (1) of this subsection.

7 “(b) For the purpose of this section—

8 “(1) the terms ‘loan or extension of credit’ and
9 ‘loans or extensions of credit’ include all advances of
10 funds to a person made on the basis of that person’s
11 obligation to repay the funds or repayable from specific
12 property pledged by or on behalf of the person;

13 “(2) the term ‘person’ includes an individual, sole
14 proprietorship, partnership, joint venture, association,
15 trust, estate, business trust, corporation, sovereign
16 government or agency, instrumentality, or political
17 subdivision thereof, or any similar entity or organiza-
18 tion; and

19 “(3) the amount of loans or extensions of credit to
20 one person shall include the amount of all loans or ex-
21 tensions of credit to all other persons where the first
22 person receives the benefit from the proceeds of such
23 loans or extensions of credit.

24 “(c) The limitations contained in subsection (a) shall be
25 subject to the following exceptions:

1 “(1) Loans or extensions of credit arising from the
2 discount of commercial or business paper evidencing an
3 obligation to the person negotiating it with recourse
4 shall not be subject to any limitation based on capital
5 and surplus.

6 “(2) The purchase of bankers’ acceptances of the
7 kind described in section 13 of the Federal Reserve
8 Act (12 U.S.C. 372 and 373) and issued by other
9 banks shall not be subject to any limitation based on
10 capital and surplus.

11 “(3) Loans or extensions of credit secured by bills
12 of lading, warehouse receipts, or similar documents
13 transferring or securing title to readily marketable sta-
14 ples shall be subject to a limitation of 25 per centum of
15 capital and surplus in addition to the general limita-
16 tions if the market value of the staples securing the ad-
17 ditional loans or extensions of credit at all times equals
18 or exceeds 115 per centum of the outstanding amount
19 of the loan or extension of credit. The staples shall be
20 fully covered by insurance whenever it is customary to
21 insure such staples.

22 “(4) Loans or extensions of credit secured by
23 bonds, notes, certificates of indebtedness, or Treasury
24 bills of the United States or by other such obligations
25 fully guaranteed as to principal and interest by the

1 United States, shall not be subject to any limitation
2 based on capital and surplus.

3 “(5) Loans or extensions of credit to or secured
4 by unconditional takeout commitments or guarantees of
5 any department, agency, bureau, board, commission, or
6 establishment of the United States or corporation—
7 wholly owned by the United States shall not be subject
8 to any limitation based on capital and surplus.

9 “(6) Loans or extensions of credit secured by a
10 segregated deposit account in the lending bank shall
11 not be subject to any limitation based on capital and
12 surplus.

13 “(7) Loans or extensions of credit to any financial
14 institution or to any receiver, conservator, superintend-
15 ent of banks, or other agent in charge of the business
16 and property of such financial institution, when such
17 loans or extensions of credit are approved by the
18 Comptroller of the Currency shall not be subject to any
19 limitation based on capital and surplus.

20 “(d) The Comptroller of the Currency may prescribe
21 rules or regulations defining or further defining terms used in
22 this section determining when loans or extensions of credit to
23 one person shall be deemed to be loans or extensions of credit
24 to any other person, or interpreting any of the provisions of
25 this section.”.

BORROWING LIMITS

1

2 SEC. 202. Section 5202 of the Revised Statutes (12
3 U.S.C. 82) is amended to read as follows:

4 "SEC. 5202. The Comptroller of the Currency may, by
5 rule or regulation, establish limitations on the amount by
6 which a national banking association may be indebted or in
7 any way subject to liability to make payments, including limi-
8 tations on both ascertainable and contingent debts and liabil-
9 ities. The Comptroller of the Currency may establish sepa-
10 rate limitations on particular types or classes of transactions
11 involving national bank indebtedness or liability and may al-
12 ternatively or additionally establish aggregate limitations on
13 total indebtedness and liability of national banking associ-
14 ations."

15

REAL ESTATE LOANS

16 SEC. 203. Section 24 of the Federal Reserve Act (12
17 U.S.C. 371) is amended to read as follows:

18

"REAL ESTATE LOANS

19 "SEC. 24. (a)(1) A national banking association may
20 make loans secured by liens on interests in real estate (here-
21 inafter referred to as 'real estate loans') in accordance with
22 the provisions of this section.

23 "(2) A lien taken by an association may be in any form
24 recognized as a perfected lien on real estate under the law of
25 the State in which the property is located. If the security for

1 a loan consists of a lien upon or the assignment of a leasehold
2 estate, the loan shall be deemed a real estate loan regardless
3 of the characterization of the bank's lien under State law; in
4 such a case the lease term must extend for at least ten years
5 beyond the maturity date of the loan.

6 “(3) The amount advanced on any real estate loan shall
7 not exceed an amount that an association can reasonably
8 expect to recover in a timely manner if required to look to
9 the lien for repayment of the loan.

10 “(4) A real estate loan shall adequately provide, through
11 a schedule of installment and other payments, a take-out
12 commitment, or a similar means, for the payment of all inter-
13 est and the repayment of the principal of the loan within a
14 reasonable period of time.

15 “(b) The limitations and restrictions of this section shall
16 not apply to—

17 “(1) a loan secured by a lien on an interest in real
18 estate but with respect to which an association does
19 not rely on the lien as the primary security, but the
20 association shall maintain on file adequate documenta-
21 tion that the primary security is other than the real
22 estate lien;

23 “(2) a real estate loan which is 20 per centum or
24 more insured or unconditionally guaranteed by the full

1 faith and credit of the United States or any agency or
2 instrumentality thereof; or

3 “(3) financing of the acquisition or development of
4 real estate, whether in the form of construction loans
5 to developers, loans to real estate purchasers, or loans
6 to other real estate lenders if, in connection with such
7 financing, there is a valid and binding agreement with
8 a financially responsible lender or other financially re-
9 sponsible party which is either entered into directly
10 with the lending association or assigned to or other-
11 wise made for the benefit of the association, pursuant
12 to which a lender or other party is unconditionally re-
13 quired to advance to the association within a reason-
14 able time after the loan is made, considering the pur-
15 pose of the association’s loan and all the facts sur-
16 rounding the particular transaction, the full amount of
17 the association’s loan.

18 “(c) An association may arrange real estate loans and
19 may purchase or sell any real estate loan obligations in whole
20 or in part.

21 “(d) No association shall make real estate loans in an
22 aggregate amount in excess of its time and savings deposits.

23 “(e) Notes representing loans made under this section to
24 finance the construction of residential or farm buildings and
25 having maturities of less than nine months shall be eligible

1. for discount as commercial paper within the terms of the
 2 second paragraph of section 13 of this Act if accompanied by
 3 a valid and binding agreement entered into by an individual,
 4 partnership, association, or corporation acceptable to the dis-
 5 counting association, to advance the full amount of the loan
 6 upon the completion of the building.

7 “(f) Any loan made pursuant to this section shall be
 8 subject to any terms, conditions, or limitations which may be
 9 prescribed by the Comptroller of the Currency by rule or
 10 regulations.”.

11 TECHNICAL AMENDMENTS

12 SEC. 204. Section 5239(b)(1) of the Revised Statutes
 13 (12 U.S.C. 93(b)(1)) is amended by inserting before “or any
 14 regulation issued pursuant thereto,” the following: “any of
 15 the provisions of the first section of the Act of September 28,
 16 1962 (76 Stat. 668; 12 U.S.C. 92a),”.

17 BANKERS BANKS

18 SEC. 205. (a) Section 5169 of the Revised Statutes (12
 19 U.S.C. 27) is amended by adding at the end thereof the fol-
 20 lowing: “The Comptroller of the Currency may also issue a
 21 certificate of authority to commence the business of banking
 22 pursuant to this section to a national banking association
 23 which is organized solely to do business with other financial
 24 institutions, their officers, directors, or employees, if such as-
 25 sociation is owned exclusively (except to the extent directors’

1 qualifying shares are required by law) by other depository
2 institutions and is engaged exclusively in providing banking
3 services for other banks and their officers, directors, and em-
4 ployees, and it does not do business with the general
5 public.”.

6 (b) Paragraph seventh of section 5136 of the Revised
7 Statutes (12 U.S.C. 24) is amended by adding at the end
8 thereof the following: “Notwithstanding any other provision
9 of this paragraph, the association may purchase for its own
10 account shares of stock of a national banking association
11 which is organized solely to do business with other financial
12 institutions, their officers, directors, or employees, if such as-
13 sociation is owned exclusively (except to the extent directors’
14 qualifying shares are required by law) by other depository
15 institutions and if such association is engaged exclusively in
16 providing banking services for other banks and their officers,
17 directors, and employees, and it does not do business with
18 the general public, but in no event shall the total amount of
19 such stock held by the association exceed at any time 10 per
20 centum of its capital stock and paid in an unimpaired surplus
21 and in no event shall the purchase of such stock result in the
22 association’s acquiring more than 5 per centum of any class
23 of voting securities of such association.”.

1 (c) Section 8(b) of the Federal Deposit Insurance Act
 2 (12 U.S.C. 1818(b)) is amended by adding at the end thereof
 3 the following:

4 “(5) This section shall apply, in the same manner as it
 5 applies to any insured bank for which the appropriate Federal
 6 banking agency is the Comptroller of the Currency, to any
 7 national banking association chartered by the Comptroller of
 8 the Currency.”.

9

VENUE PROVISION

10 SEC. 206. Section 5198 of the Revised Statutes (12
 11 U.S.C. 94) is amended to read as follows:

12 “SEC. 5198. Actions and proceedings against any asso-
 13 ciation under this title, for which the Federal Deposit Insur-
 14 ance Corporation has been appointed as receiver, may be
 15 brought in any district or territorial court of the United
 16 States within the district in which said association is located
 17 or in any State, county, or municipal court, having jurisdic-
 18 tion in similar cases, in the county or city in which said asso-
 19 ciation is located.”.

20

LEGAL HOLIDAYS

21 SEC. 207. The last sentence of section 4(b)(1) of the Act
 22 of March 9, 1933 (12 U.S.C. 95(b)(1)) is amended to read as
 23 follows: “In the event that a State official authorized by law
 24 designates any day as a legal holiday for ceremonial or emer-
 25 gency reasons, for the State or any part thereof, that same

1 day shall be a legal holiday for all national banking associ-
 2 ations or their offices located in that State or the part so
 3 affected. A national banking association or its affected offices
 4 may close or remain open on such a legal holiday unless the
 5 Comptroller of the Currency by written order directs other-
 6 wise.”.

7 **AMENDMENTS TO DEREGULATION ACT**

8 **SEC. 208. (a)** Sections 721 and 722 of the Depository
 9 Institutions Deregulation and Monetary Control Act of 1980
 10 (12 U.S.C. 191 note) are amended by striking out the phrase
 11 “closed on or before January 22, 1934” each place it ap-
 12 pears and inserting in lieu thereof “which have been closed
 13 and for which the Comptroller has appointed a receiver other
 14 than the Federal Deposit Insurance Corporation”.

15 (b) Title VII of such Act is amended by adding after
 16 section 723 the following:

17 **“PART C—DISPOSITION OF UNCLAIMED PROPERTY**
 18 **RECOVERED FROM CLOSED NATIONAL BANKS**

19 **“PURPOSE**

20 **“SEC. 731.** The purpose of this part is to dispose of
 21 unclaimed property in the possession, custody, or control of
 22 the Comptroller of the Currency by—

23 **“(1)** providing final notice of the availability of
 24 unclaimed property from closed national banks;

1 “(2) barring rights of claimants to obtain such
2 property from the Comptroller after a reasonable
3 period of time following such notice; and

4 “(3) authorizing the Comptroller to dispose of
5 such property for which no claims have been filed
6 under this part.

7 “DEFINITIONS

8 “SEC. 732. For purposes of this part—

9 “(1) the term ‘Comptroller’ means the Comptrol-
10 ler of the Currency;

11 “(2) the term ‘unclaimed property’ means any ar-
12 ticles, items, assets, other property, or the proceeds
13 thereof from safe deposit boxes or other safekeeping
14 arrangements with closed national banks, in the pos-
15 session, custody, or control of the Comptroller in its
16 capacity as successor to receivers of those banks; and

17 “(3) the term ‘claimant’ means any person or
18 entity asserting a legal interest in title to or possession
19 of unclaimed property.

20 “DISPOSITION OF UNCLAIMED PROPERTY

21 “SEC. 733. (a) Within one hundred and eighty days fol-
22 lowing the date of the enactment of this part, the Comptrol-
23 ler shall publish notice once a week for four weeks in the
24 Federal Register that all claims to rights of any person or
25 entity to obtain possession of any unclaimed property in the

1 possession, custody, or control of the Comptroller must be
2 filed within twelve months following the last date of publica-
3 tion of such notice or shall thereafter be barred. Such notice
4 shall contain the names of last known owners, if any, names
5 and locations of affected closed banks, and a general descrip-
6 tion of the types of unclaimed property held by the Comptrol-
7 ler. Reasonable opportunity for inspection of subject property
8 by possible claimants shall be provided in Washington, Dis-
9 trict of Columbia.

10 “(b) The Comptroller shall deliver such property to any
11 demonstrably rightful owner or his or her authorized repre-
12 sentative upon receiving adequate proof that such claimant is
13 entitled to the property, but only if the claimant files for the
14 property within twelve months following the last date notice
15 is published. Such proof shall include convincing documen-
16 tary evidence of entitlement, together with an affidavit by the
17 claimant attesting to his or her rights or interest in the prop-
18 erty. The Comptroller shall have authority to determine the
19 validity of all claims filed. All expenses associated with the
20 delivery of any property shall be borne by the claimant.

21 “(c) If, after twelve months from the date final notice is
22 published, any such property remains in the possession, cus-
23 tody, or control of the Comptroller for which no valid claim
24 has been filed, all rights, title, and interest in such property
25 shall immediately be vested in the United States. The Comp-

1 troller shall thereupon, in its discretion, sell, use, destroy, or
2 otherwise dispose of any such unclaimed property. The pro-
3 ceeds of any sale authorized by this provision, after recoup-
4 ment by the Comptroller of any expenses incident thereto,
5 shall be covered into the Treasury as miscellaneous receipts.

6 “(d) The Comptroller or any officer, employee, or agent
7 of the Comptroller of the United States shall not be subject to
8 legal liability for delivery, sale, destruction, or other disposi-
9 tion of any unclaimed property made in accordance with this
10 part.

11 “RULEMAKING AUTHORITY

12 “SEC. 734. The Comptroller may issue rules and regu-
13 lations necessary or appropriate to carry out this part.”.

14 BANKERS ACCEPTANCES

15 SEC. 209. The seventh paragraph of section 13 of the
16 Federal Reserve Act (12 U.S.C. 372) is amended to read as
17 follows:

18 “A member bank may accept drafts or bills of exchange
19 drawn upon it having not more than six months sight to run,
20 exclusive of days of grace, which grow out of transactions
21 involving the importation or exportation of goods, which
22 grow out of transactions involving the domestic shipment of
23 goods, or which are secured at the time of acceptance by a
24 warehouse receipt or other such document conveying or se-
25 curing title covering readily marketable staples. No member

1 bank shall accept such bills for which it shall not be and
2 remain fully secured to an amount equal at any time in the
3 aggregate to more than 200 per centum of its paid-up and
4 unimpaired capital stock and surplus but the Board, under
5 such conditions as it may prescribe, may authorize, by regu-
6 lation or order, any member bank to accept such bills for
7 which such member bank shall not be and remain fully se-
8 cured to an amount not exceeding at any time in the aggre-
9 gate 300 per centum of its paid-up and unimpaired capital
10 stock and surplus. No member bank shall accept, whether in
11 a foreign or domestic transaction, for any one person, part-
12 nership, corporation, association, or other entity to any
13 amount equal at any time in the aggregate to more than 10
14 per centum of its paid-up and unimpaired capital stock and
15 surplus, unless such member bank is secured either by at-
16 tached documents or by some other actual security growing
17 out of the same transaction as the acceptance. Amounts (i)
18 representing the shipment of goods where a member bank is
19 fully covered by primary obligations to reimburse it that are
20 also guaranteed by banks, bankers, or corporations regulated
21 under section 25 or 25a of this Act; or (ii) with respect to
22 which a member bank is covered by participation agreements
23 from other banks or corporations regulated under section 25
24 or 25a of this Act shall not be counted toward the limitations
25 in the preceding two sentences. In order to effectuate the

1 purposes of this paragraph, the Board may define any of the
2 terms used herein.”.

3 **BANKING AFFILIATES**

4 **SEC. 210. (a)** This section may be cited as the “Banking
5 Affiliates Act”.

6 (b) Section 23A of the Federal Reserve Act (12 U.S.C.
7 371c) is amended to read as follows:

8 “SEC. 23A. (a) Restrictions on Transactions With Af-
9 filiates.—

10 “(1) A member bank and its subsidiaries may
11 engage in a covered transaction with an affiliate only
12 if—

13 “(A) the covered transaction is made on sub-
14 stantially the same terms as those prevailing at
15 the time for comparable transactions with other
16 nonaffiliated companies;

17 “(B) in the case of any affiliate, the aggre-
18 gate amount of covered transactions of the
19 member bank and its subsidiaries will not exceed
20 10 per centum of the capital stock and surplus of
21 the member bank; and

22 “(C) in the case of all affiliates, the aggre-
23 gate amount of covered transactions of the
24 member bank and its subsidiaries will not exceed

1 20 per centum of the capital stock and surplus of
2 the member bank.

3 “(2) A member bank and its subsidiaries may not
4 purchase a low-quality asset.

5 “(b) DEFINITIONS.—For the purpose of this section—

6 “(1) any transaction with a director, officer, or
7 other employee or with any representative of an affi-
8 late shall be deemed to be a transaction with the affi-
9 late to the extent that the proceeds of the transaction
10 are used for the benefit of, or transferred to, the affi-
11 late;

12 “(2) except in the case of a company that controls
13 the member bank, any transaction with a subsidiary of
14 an affiliate or with a subsidiary of that subsidiary shall
15 be deemed to be a transaction with such affiliate;

16 “(3) the term ‘affiliate’ with respect to a member
17 bank means—

18 “(A) any company that controls the member
19 bank and any other company that is controlled by
20 the company that controls the member bank;

21 “(B) a bank subsidiary of the member bank;

22 “(C) any company (i) that is controlled di-
23 rectly or indirectly, by trust or otherwise, by or
24 for the benefit of shareholders who beneficially or
25 otherwise control, directly or indirectly, by trust

1 or otherwise, the member bank or any company
2 that controls the member bank; or (ii) in which a
3 majority of its directors or trustees constitute a
4 majority of the persons holding any such office
5 with the member bank or any company that con-
6 trols the member bank;

7 “(D) any company, including a real estate in-
8 vestment trust, that is sponsored and advised on a
9 contractual basis by the member bank or any sub-
10 subsidiary or affiliate of the member bank; and

11 “(E) any company that the Board determines
12 by regulation or order to have a relationship with
13 the member bank or any subsidiary or affiliate of
14 the member bank, such that judgments by the
15 member bank or its subsidiary, with respect to
16 transactions with such company, may be affected
17 by the relationship to the detriment of the
18 member bank or its subsidiary;

19 “(4) the following shall not be considered to be an
20 affiliate:

21 “(A) any company, other than a bank, that is
22 a subsidiary of the member bank;

23 “(B) any company engaged solely in holding
24 the premises of the member bank with which it is
25 affiliated;

1 “(C) any company engaged solely in con-
2 ducting a safe deposit business;

3 “(D) any company engaged solely in holding
4 obligations of the United States or its agencies or
5 obligations fully guaranteed by the United States
6 or its agencies as to principal and interest; and

7 “(E) any company where control results from
8 the exercise of rights arising out of a bona fide
9 debt previously contracted, but only for the period
10 of time specifically authorized under applicable
11 State or Federal law or regulation or in the ab-
12 sence of such law or regulation for a period of
13 two years from the date of the exercise of such
14 rights or the effective date of this Act, whichever
15 date is later, subject, upon application for good
16 cause shown, to authorization by the Board for
17 extensions of time for not more than one year at a
18 time, but such extensions in the aggregate shall
19 not exceed three years;

20 “(5)(A) a company or shareholder shall be deemed
21 to have control over another company if—

22 “(i) such company or shareholder, directly or
23 indirectly, or acting through one or more other
24 persons owns, controls, or has power to vote 25

1 per centum or more of any class of voting securi-
2 ties of the other company;

3 “(ii) such company or shareholder controls in
4 any manner the election of a majority of the di-
5 rectors or trustees of the other company; or

6 “(iii) the Board determines, after notice and
7 opportunity for hearing, that such company or
8 shareholder, directly or indirectly, exercises a con-
9 trolling influence over the management or policies
10 of the other company; and

11 “(B) notwithstanding any other provision of this
12 subsection, no company shall be deemed to own or
13 control another company by virtue of its ownership or
14 control of shares in a fiduciary capacity, except as pro-
15 vided in paragraph (3)(B), but shares shall not be
16 deemed to be owned or controlled in a fiduciary capac-
17 ity if the company owning or controlling such shares
18 has sole discretionary authority to exercise voting
19 rights with respect thereto, or if the company owning
20 or controlling such shares is a business trust;

21 “(6) the term ‘subsidiary’ with respect to a speci-
22 fied company means a company that is controlled by
23 such specified company;

24 “(7) the term ‘bank’ means any institution orga-
25 nized under the laws of the United States, any State of

1 the United States, the District of Columbia, any terri-
2 tory of the United States, Puerto Rico, Guam, Ameri-
3 can Samoa, or the United States Virgin Islands which
4 (A) accepts deposits that the depositor has a legal right
5 to withdraw on demand, and (B) engages in the busi-
6 ness of making commercial loans. Such term does not
7 include any company operating under section 25 or
8 section 25(a) of the Federal Reserve Act, or any com-
9 pany which does not do business within the United
10 States or whose only business within the United States
11 is incidental to its activities outside the United States;

12 “(8) the term ‘company’ means a corporation,
13 partnership, business trust, association or similar orga-
14 nization. Unless specifically excluded, the term ‘compa-
15 ny’ includes a ‘member bank’ and a ‘bank’;

16 “(9) the term ‘covered transaction’ means with re-
17 spect to an affiliate of a member bank—

18 “(A) a loan or extension of credit to the affil-
19 iate;

20 “(B) a purchase of or an investment in secu-
21 rities of the affiliate;

22 “(C) a purchase of assets, including assets
23 subject to an agreement to repurchase, from the
24 affiliate;

1 “(D) the acceptance of securities of the affili-
2 ate as collateral security for a loan or extension of
3 credit to any person or company; or

4 “(E) the issuance of an acceptance, guaran-
5 tee, or letter of credit, including an endorsement
6 or standby letter of credit to, or on behalf of, an
7 affiliate;

8 “(10) the term ‘aggregate amount of covered
9 transactions’ means the amount of the covered transac-
10 tions about to be engaged in added to the current
11 amount of all outstanding covered transactions;

12 “(11) the term ‘securities’ means stocks, bonds,
13 debentures, notes, or other similar obligations; and

14 “(12) the term ‘low-quality asset’ means an asset
15 that falls in any one or more of the following catego-
16 ries:

17 “(A) an asset classified as ‘substandard’,
18 ‘doubtful’, or ‘loss’ or treated as ‘other loans es-
19 pecially mentioned’ in the most recent report of
20 examination prepared by either a Federal or State
21 supervisory agency;

22 “(B) an asset in a nonaccrual status;

23 “(C) an asset on which principal or interest
24 payments are more than thirty days past due; or

1 “(D) an asset whose terms have been re-
2 negotiated or compromised due to the deteriorat-
3 ing financial condition of the obligor.

4 “(c) EXEMPTIONS.—The provisions of this section shall
5 not be applicable to—

6 “(1) any transaction, except for the purchase of a
7 low-quality asset, with a bank—

8 “(A) which controls 80 per centum or more
9 of the voting shares of the member bank;

10 “(B) in which the member bank controls 80
11 per centum or more of the voting shares; or

12 “(C) in which 80 per centum or more of the
13 voting shares are controlled by the company that
14 controls 80 per centum or more of the voting
15 shares of the member bank;

16 “(2) making noninterest bearing deposits in an af-
17 filiated bank;

18 “(3) giving immediate credit to an affiliated bank
19 for uncollected items received in the ordinary course of
20 business;

21 “(4) making any loan or extension of credit to any
22 affiliate that is fully secured by obligations of the
23 United States or its agencies or obligations fully guar-
24 anteed by the United States or its agencies as to prin-
25 cipal and interest;

1 “(5) purchasing securities of any company of the
2 kinds described in section 4(c)(1) of the Bank Holding
3 Company Act of 1956; and

4 “(6) purchasing assets having a readily identifiable
5 and publicly available market quotation and purchased
6 at that market quotation.

7 “(d) SECURITY FOR CERTAIN TRANSACTIONS WITH
8 AFFILIATES.—

9 “(1) Each loan or extension of credit to, or guar-
10 antee, acceptance, or letter of credit issued to, or on
11 behalf of, an affiliate by a member bank or its subsidi-
12 ary shall be secured at the time of the transaction by
13 collateral having a market value equal to—

14 “(A) 100 per centum of the amount of such
15 loan or extension of credit, guarantee, acceptance,
16 or letter of credit if the collateral is composed of
17 obligations of the United States or its agencies or
18 obligations fully guaranteed by the United States
19 or its agencies as to principal and interest, or
20 notes, drafts, bills of exchange or bankers’ accept-
21 ances that are eligible for rediscount or purchase
22 by the Federal Reserve Banks;

23 “(B) 110 per centum of the amount of such
24 loan or extension of credit, guarantee, acceptance,
25 or letter of credit if the collateral is composed of

1 obligations of any State or political subdivision of
2 any State;

3 “(C) 120 per centum of the amount of such
4 loan or extension of credit, guarantee, acceptance,
5 or letter of credit if the collateral is composed of
6 other debt instruments, including receivables; or

7 “(D) 130 per centum of the amount of such
8 loan or extension of credit, guarantee, acceptance,
9 or letter of credit if the collateral is composed of
10 stock, leases, or other real or personal property.

11 “(2) Any such collateral that is subsequently re-
12 tired or amortized shall be replaced by additional eligi-
13 ble collateral where needed to keep the percentage of
14 the collateral value relative to the amount of the out-
15 standing loan or extension of credit, guarantee, accept-
16 ance, or letter of credit equal to the minimum percent-
17 age required at the inception of the transaction.

18 “(3) A low-quality asset shall not be acceptable as
19 collateral.

20 “(4) The securities of an affiliate of the member
21 bank shall not be acceptable as collateral for a loan or
22 extension of credit to, or guarantee, acceptance, or
23 letter of credit issued to, or on behalf of, that affiliate
24 or any other affiliate of the member bank.

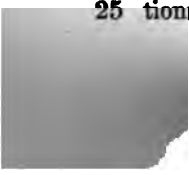
1 “(5) The collateral requirements of this paragraph
2 shall not be applicable to an acceptance that is already
3 fully secured either by attached documents or by other
4 property having an ascertainable market value that is
5 involved in the transaction.

6 “(e) RULEMAKING AND ADDITIONAL EXEMPTIONS.—

7 “(1) The Board may prescribe, by regulation or
8 order, limitations or other requirements as to any
9 transactions with any company in which the member
10 bank or a bank affiliate of the member bank owns, di-
11 rectly or indirectly, a minority equity interest other
12 than in a fiduciary capacity, and may issue such fur-
13 ther regulations and orders, including definitions con-
14 sistent with this section, as may be necessary to ad-
15 minister and carry out the purposes of this section and
16 to prevent evasions thereof.

17 “(2) The Board may, at its discretion, by regula-
18 tion or order exempt transactions or relationships from
19 the requirements of this section if it finds such exemp-
20 tions to be in the public interest and consistent with
21 the purposes of this section.”.

22 (c) Section 23A of the Federal Reserve Act, as amended
23 by this section, shall apply to any transaction entered into
24 after the date of enactment of this Act, except for transac-
25 tions which are the subject of a binding written contract or



1 commitment entered into on or before , 1981,
 2 and except that any renewal of a participation loan outstand-
 3 ing on , 1981, to a company that becomes an
 4 affiliate as a result of the enactment of this Act, or any par-
 5 ticipation loan to such an affiliate emanating from the renew-
 6 al of a binding written contract or commitment outstanding
 7 on , 1981, shall not be subject to the collateral
 8 requirements of this Act.

9 (d) Section 18(j) of the Federal Deposit Insurance Act
 10 (12 U.S.C. 1828(j)) is amended by striking out “, within the
 11 meaning of section 2 of the Banking Act of 1933, as amend-
 12 ed, and”.

13 EXEMPTION FROM RESERVE REQUIREMENTS

14 SEC. 211. (a) Section 19(b)(9) of the Federal Reserve
 15 Act (12 U.S.C. 461(b)(9)) is amended—

16 (1) by inserting “(A)” after “(9)”; and

17 (2) by adding at the end thereof the following:

18 “(B) Requirements imposed under paragraph (2)
 19 of this subsection shall not apply to any depository in-
 20 stitution which has less than \$5,000,000 in deposits as
 21 of the close of its most recent full fiscal year, which
 22 amount shall be adjusted as provided in subparagraph
 23 (C).

24 “(C) Not later than December 31 of each year be-
 25 ginning in 1982, the Board shall issue a regulation in-

1 creasing for the next succeeding calendar year the
2 dollar amount contained in subparagraph (B) (or which
3 was last determined pursuant to this subparagraph) by
4 an amount obtained by multiplying such dollar amount
5 by 80 per centum of the percentage increase in the
6 total deposits of all depository institutions. The Board
7 may calculate the amount of the increase by using in-
8 formation on deposits received periodically by the
9 Board for selected depository institutions. The increase
10 in deposits shall be determined by subtracting the
11 amount of such deposits on June 30th of the preceding
12 calendar year from the amount of such deposits on
13 June 30th of the calendar year involved. No adjust-
14 ment will be made for a decrease in total deposits.”.

15 (b) Section 19(b)(7) of the Federal Reserve Act is
16 amended by inserting “including those exempted under sub-
17 paragraph (9)(B)” after “Any depository institution”.

18 (c) Section 11A(c)(2) of the Federal Reserve Act is
19 amended by inserting “including those exempted under sub-
20 section 19(b)(9) of this Act” after “nonmember depository
21 institution”.

1 **PART B—FINANCIAL INSTITUTIONS REGULATORY ACT**2 **AMENDMENTS**3 **LOAN LIMITS**

4 **SEC. 221.** Section 22(g) of the Federal Reserve Act (12
5 U.S.C. 375a) is amended by deleting the phrase “not exceed-
6 ing \$60,000” in paragraph (2), and by deleting the phrase “,
7 not exceeding the aggregate amount of \$20,000 outstanding
8 at any one time,” in paragraph (3).

9 **CIVIL PENALTIES**

10 **SEC. 222.** Subsection (l)(1) of section 19 of the Federal
11 Reserve Act (12 U.S.C. 505(1)); section 5(d)(8)(B)(i) of the
12 Home Owners’ Loan Act (12 U.S.C. 1464(d)(8)(B)(i)); sec-
13 tion 8(b)(1) of the Bank Holding Company Act of 1956 (12
14 U.S.C. 1847(b)(1)); and section 106(b)(2)(F)(i) of the Bank
15 Holding Company Act Amendments of 1970 (12 U.S.C.
16 1972(2)(F)(i)), are amended by inserting before the period at
17 the end thereof the following: “: *Provided*, That the agency
18 having authority to impose a civil money penalty may, in its
19 discretion, compromise, modify, or remit any civil money
20 penalty which is subject to imposition or has been imposed
21 under such authority”.

22 **REPEAL OF REPORTING REQUIREMENT**

23 **SEC. 223.** Section 22(g) of the Federal Reserve Act (12
24 U.S.C. 375a) is amended by striking out paragraph (9) (12

1 U.S.C. 375a(9)), and redesignating paragraph (10) as para-
2 graph (9).

3 **DISCRETIONARY ASSESSMENT AND COLLECTION**

4 **SEC. 224.** Each of the following provisions is amended
5 by striking the term "shall" and inserting in lieu thereof the
6 term "may":

7 (1) the second sentence of section 29 of the Fed-
8 eral Reserve Act (12 U.S.C. 504(a));

9 (2) the second sentence of section 19(l)(1) of the
10 Federal Reserve Act (19 U.S.C. 505(1));

11 (3) the second sentence of section 5239(b)(1) of
12 the Revised Statutes (12 U.S.C. 93(b)(1));

13 (4) the second sentence of section 8(b)(1) of the
14 Bank Holding Company Act of 1956 (12 U.S.C.
15 1847(b)(1));

16 (5) the second sentence of section 408(j)(4)(A) of
17 the National Housing Act (12 U.S.C. 1730a(j)(4)(A));

18 (6) the second sentence of section 8(i)(2)(i) of the
19 Federal Deposit Insurance Act (12 U.S.C.
20 1818(i)(2)(i));

21 (7) the second sentence of section 407(k)(3)(A) of
22 the National Housing Act (12 U.S.C. 1730(k)(3)(A));

23 (8) the second sentence of section 5(d)(8)(B)(i) of
24 the Home Owners' Loan Act (12 U.S.C.
25 1464(d)(8)(B)(i));

1 (9) the second sentence of section 206(j)(2)(A) of
 2 the Federal Credit Union Act (12 U.S.C.
 3 1786(j)(2)(A));

4 (10) the second sentence of section 18(j)(3)(A) of
 5 the Federal Deposit Insurance Act (12 U.S.C.
 6 1828(j)(3)(A)); and

7 (11) the second sentence of section 106(b)(2)(F)(i)
 8 of the Bank Holding Company Act Amendments of
 9 1970 (12 U.S.C. 1972(2)(F)(i)).

10 APPROVAL OF CERTAIN LOANS

11 SEC. 225. Section 22(h)(2) of the Federal Reserve Act
 12 (12 U.S.C. 375b(2)) is amended by striking the phrase "a
 13 majority of the entire" and inserting "the" in lieu thereof.

14 LOANS TO OFFICERS OF SUBSIDIARIES

15 SEC. 226. Subparagraphs (D) and (E) of section 22(h)(6)
 16 of the Federal Reserve Act (12 U.S.C. 375b(6)) are amended
 17 by striking out the phrase ", or with any other subsidiary of
 18 such bank holding company" each place it appears therein.

19 TECHNICAL AMENDMENTS

20 SEC. 227. (a) Section 5239(b)(1) of the Revised Statutes
 21 is amended by striking out "chapter" and inserting in lieu
 22 thereof "Title".

- 23 (b) Section 407(h)(1) of the National Housing Act (12
 24 U.S.C. 1730(h)(1)) is amended—

1 (1) by striking out "persons" in the first sentence
2 and inserting in lieu thereof "person"; and

3 (2) by striking out "(3)" in the last sentence and
4 inserting in lieu thereof "(2)".

5 (c) The first sentence of section 8(b)(3) of the Federal
6 Deposit Insurance Act (12 U.S.C. 1818(b)(3)) is amended by
7 striking out "25A" and inserting in lieu thereof "25(a)".

8 **EXCLUSION OF FOREIGN BANKS**

9 **SEC. 228.** Section 18(j)(2) of the Federal Deposit Insur-
10 ance Act (12 U.S.C. 1828(j)(2)) is amended by adding at the
11 end thereof the following: "The provisions of this subsection
12 shall not apply to any foreign bank, as defined in section
13 1(b)(7) of Public Law 95-369 (12 U.S.C. 3101(7)) having an
14 insured branch in the United States, but shall apply to the
15 insured branch."

16 **TECHNICAL AMENDMENTS**

17 **SEC. 229. (a)** Section 107(a)(1) of the Financial Institu-
18 tions Regulatory and Interest Rate Control Act of 1978 is
19 amended by striking out "Section 8(b)" and inserting in lieu
20 thereof "Sections 8(b)(1) and 8(b)(2)" and by striking out
21 "(12 U.S.C. 1818(b)) is" and inserting in lieu thereof "(12
22 U.S.C. 1818(b)(1) and (b)(2)) are".

23 (b) Section 205(2) of the Depository Institution Manage-
24 ment Interlocks Act (12 U.S.C. 3204(2)) is amended by
25 striking "25A" and inserting in lieu thereof "25(a)".

1 “(D) an asset whose terms have been re-
2 negotiated or compromised due to the deteriorat-
3 ing financial condition of the obligor.

4 “(c) EXEMPTIONS.—The provisions of this section shall
5 not be applicable to—

6 “(1) any transaction, except for the purchase of a
7 low-quality asset, with a bank—

8 “(A) which controls 80 per centum or more
9 of the voting shares of the member bank;

10 “(B) in which the member bank controls 80
11 per centum or more of the voting shares; or

12 “(C) in which 80 per centum or more of the
13 voting shares are controlled by the company that
14 controls 80 per centum or more of the voting
15 shares of the member bank;

16 “(2) making noninterest bearing deposits in an af-
17 filiated bank;

18 “(3) giving immediate credit to an affiliated bank
19 for uncollected items received in the ordinary course of
20 business;

21 “(4) making any loan or extension of credit to any
22 affiliate that is fully secured by obligations of the
23 United States or its agencies or obligations fully guar-
24 anteed by the United States or its agencies as to prin-
25 cipal and interest;

1 “(5) purchasing securities of any company of the
2 kinds described in section 4(c)(1) of the Bank Holding
3 Company Act of 1956; and

4 “(6) purchasing assets having a readily identifiable
5 and publicly available market quotation and purchased
6 at that market quotation.

7 “(d) SECURITY FOR CERTAIN TRANSACTIONS WITH
8 AFFILIATES.—

9 “(1) Each loan or extension of credit to, or guar-
10 antee, acceptance, or letter of credit issued to, or on
11 behalf of, an affiliate by a member bank or its subsidi-
12 ary shall be secured at the time of the transaction by
13 collateral having a market value equal to—

14 “(A) 100 per centum of the amount of such
15 loan or extension of credit, guarantee, acceptance,
16 or letter of credit if the collateral is composed of
17 obligations of the United States or its agencies or
18 obligations fully guaranteed by the United States
19 or its agencies as to principal and interest, or
20 notes, drafts, bills of exchange or bankers’ accept-
21 ances that are eligible for rediscount or purchase
22 by the Federal Reserve Banks;

23 “(B) 110 per centum of the amount of such
24 loan or extension of credit, guarantee, acceptance,
25 or letter of credit if the collateral is composed of

1 obligations of any State or political subdivision of
2 any State;

3 “(C) 120 per centum of the amount of such
4 loan or extension of credit, guarantee, acceptance,
5 or letter of credit if the collateral is composed of
6 other debt instruments, including receivables; or

7 “(D) 130 per centum of the amount of such
8 loan or extension of credit, guarantee, acceptance,
9 or letter of credit if the collateral is composed of
10 stock, leases, or other real or personal property.

11 “(2) Any such collateral that is subsequently re-
12 tired or amortized shall be replaced by additional eligi-
13 ble collateral where needed to keep the percentage of
14 the collateral value relative to the amount of the out-
15 standing loan or extension of credit, guarantee, accept-
16 ance, or letter of credit equal to the minimum percent-
17 age required at the inception of the transaction.

18 “(3) A low-quality asset shall not be acceptable as
19 collateral.

20 “(4) The securities of an affiliate of the member
21 bank shall not be acceptable as collateral for a loan or
22 extension of credit to, or guarantee, acceptance, or
23 letter of credit issued to, or on behalf of, that affiliate
24 or any other affiliate of the member bank.

1 “(5) The collateral requirements of this paragraph
2 shall not be applicable to an acceptance that is already
3 fully secured either by attached documents or by other
4 property having an ascertainable market value that is
5 involved in the transaction.

6 “(e) RULEMAKING AND ADDITIONAL EXEMPTIONS.—

7 “(1) The Board may prescribe, by regulation or
8 order, limitations or other requirements as to any
9 transactions with any company in which the member
10 bank or a bank affiliate of the member bank owns, di-
11 rectly or indirectly, a minority equity interest other
12 than in a fiduciary capacity, and may issue such fur-
13 ther regulations and orders, including definitions con-
14 sistent with this section, as may be necessary to ad-
15 minister and carry out the purposes of this section and
16 to prevent evasions thereof.

17 “(2) The Board may, at its discretion, by regula-
18 tion or order exempt transactions or relationships from
19 the requirements of this section if it finds such exemp-
20 tions to be in the public interest and consistent with
21 the purposes of this section.”.

22 (c) Section 23A of the Federal Reserve Act, as amended
23 by this section, shall apply to any transaction entered into
24 after the date of enactment of this Act, except for transac-
25 tions which are the subject of a binding written contract or

1 commitment entered into on or before , 1981,
 2 and except that any renewal of a participation loan outstand-
 3 ing on , 1981, to a company that becomes an
 4 affiliate as a result of the enactment of this Act, or any par-
 5 ticipation loan to such an affiliate emanating from the renew-
 6 al of a binding written contract or commitment outstanding
 7 on , 1981, shall not be subject to the collateral
 8 requirements of this Act.

9 (d) Section 18(j) of the Federal Deposit Insurance Act
 10 (12 U.S.C. 1828(j)) is amended by striking out “, within the
 11 meaning of section 2 of the Banking Act of 1933, as amend-
 12 ed, and”.

13 **EXEMPTION FROM RESERVE REQUIREMENTS**

14 **SEC. 211. (a)** Section 19(b)(9) of the Federal Reserve
 15 Act (12 U.S.C. 461(b)(9)) is amended—

16 (1) by inserting “(A)” after “(9)”; and

17 (2) by adding at the end thereof the following:

18 “(B) Requirements imposed under paragraph (2)
 19 of this subsection shall not apply to any depository in-
 20 stitution which has less than \$5,000,000 in deposits as
 21 of the close of its most recent full fiscal year, which
 22 amount shall be adjusted as provided in subparagraph
 23 (C).

24 “(C) Not later than December 31 of each year be-
 25 ginning in 1982, the Board shall issue a regulation in-

1 creasing for the next succeeding calendar year the
2 dollar amount contained in subparagraph (B) (or which
3 was last determined pursuant to this subparagraph) by
4 an amount obtained by multiplying such dollar amount
5 by 80 per centum of the percentage increase in the
6 total deposits of all depository institutions. The Board
7 may calculate the amount of the increase by using in-
8 formation on deposits received periodically by the
9 Board for selected depository institutions. The increase
10 in deposits shall be determined by subtracting the
11 amount of such deposits on June 30th of the preceding
12 calendar year from the amount of such deposits on
13 June 30th of the calendar year involved. No adjust-
14 ment will be made for a decrease in total deposits.”.

15 (b) Section 19(b)(7) of the Federal Reserve Act is
16 amended by inserting “including those exempted under sub-
17 paragraph (9)(B)” after “Any depository institution”.

18 (c) Section 11A(c)(2) of the Federal Reserve Act is
19 amended by inserting “including those exempted under sub-
20 section 19(b)(9) of this Act” after “nonmember depository
21 institution”.

1 **PART B—FINANCIAL INSTITUTIONS REGULATORY ACT**2 **AMENDMENTS**3 **LOAN LIMITS**

4 **SEC. 221.** Section 22(g) of the Federal Reserve Act (12
5 U.S.C. 375a) is amended by deleting the phrase “not exceed-
6 ing \$60,000” in paragraph (2), and by deleting the phrase “,
7 not exceeding the aggregate amount of \$20,000 outstanding
8 at any one time,” in paragraph (3).

9 **CIVIL PENALTIES**

10 **SEC. 222.** Subsection (l)(1) of section 19 of the Federal
11 Reserve Act (12 U.S.C. 505(1)); section 5(d)(8)(B)(i) of the
12 Home Owners’ Loan Act (12 U.S.C. 1464(d)(8)(B)(i)); sec-
13 tion 8(b)(1) of the Bank Holding Company Act of 1956 (12
14 U.S.C. 1847(b)(1)); and section 106(b)(2)(F)(i) of the Bank
15 Holding Company Act Amendments of 1970 (12 U.S.C.
16 1972(2)(F)(i)), are amended by inserting before the period at
17 the end thereof the following: “: *Provided*, That the agency
18 having authority to impose a civil money penalty may, in its
19 discretion, compromise, modify, or remit any civil money
20 penalty which is subject to imposition or has been imposed
21 under such authority”.

22 **REPEAL OF REPORTING REQUIREMENT**

23 **SEC. 223.** Section 22(g) of the Federal Reserve Act (12
24 U.S.C. 375a) is amended by striking out paragraph (9) (12

1 U.S.C. 375a(9)), and redesignating paragraph (10) as para-
2 graph (9).

3 **DISCRETIONARY ASSESSMENT AND COLLECTION**

4 **SEC. 224.** Each of the following provisions is amended
5 by striking the term "shall" and inserting in lieu thereof the
6 term "may":

7 (1) the second sentence of section 29 of the Fed-
8 eral Reserve Act (12 U.S.C. 504(a));

9 (2) the second sentence of section 19(l)(1) of the
10 Federal Reserve Act (19 U.S.C. 505(1));

11 (3) the second sentence of section 5239(b)(1) of
12 the Revised Statutes (12 U.S.C. 93(b)(1));

13 (4) the second sentence of section 8(b)(1) of the
14 Bank Holding Company Act of 1956 (12 U.S.C.
15 1847(b)(1));

16 (5) the second sentence of section 408(j)(4)(A) of
17 the National Housing Act (12 U.S.C. 1730a(j)(4)(A));

18 (6) the second sentence of section 8(i)(2)(i) of the
19 Federal Deposit Insurance Act (12 U.S.C.
20 1818(i)(2)(i));

21 (7) the second sentence of section 407(k)(3)(A) of
22 the National Housing Act (12 U.S.C. 1730(k)(3)(A));

23 (8) the second sentence of section 5(d)(8)(B)(i) of
24 the Home Owners' Loan Act (12 U.S.C.
25 1464(d)(8)(B)(i));

1 (9) the second sentence of section 206(j)(2)(A) of
 2 the Federal Credit Union Act (12 U.S.C.
 3 1786(j)(2)(A));

4 (10) the second sentence of section 18(j)(3)(A) of
 5 the Federal Deposit Insurance Act (12 U.S.C.
 6 1828(j)(3)(A)); and

7 (11) the second sentence of section 106(b)(2)(F)(i)
 8 of the Bank Holding Company Act Amendments of
 9 1970 (12 U.S.C. 1972(2)(F)(i)).

10 APPROVAL OF CERTAIN LOANS

11 SEC. 225. Section 22(h)(2) of the Federal Reserve Act
 12 (12 U.S.C. 375b(2)) is amended by striking the phrase "a
 13 majority of the entire" and inserting "the" in lieu thereof.

14 LOANS TO OFFICERS OF SUBSIDIARIES

15 SEC. 226. Subparagraphs (D) and (E) of section 22(h)(6)
 16 of the Federal Reserve Act (12 U.S.C. 375b(6)) are amended
 17 by striking out the phrase ", or with any other subsidiary of
 18 such bank holding company" each place it appears therein.

19 TECHNICAL AMENDMENTS

20 SEC. 227. (a) Section 5239(b)(1) of the Revised Statutes
 21 is amended by striking out "chapter" and inserting in lieu
 22 thereof "Title".

- 23 (b) Section 407(h)(1) of the National Housing Act (12
 24 U.S.C. 1730(h)(1)) is amended—

1 (1) by striking out "persons" in the first sentence
2 and inserting in lieu thereof "person"; and

3 (2) by striking out "(3)" in the last sentence and
4 inserting in lieu thereof "(2)".

5 (c) The first sentence of section 8(b)(3) of the Federal
6 Deposit Insurance Act (12 U.S.C. 1818(b)(3)) is amended by
7 striking out "25A" and inserting in lieu thereof "25(a)".

8 EXCLUSION OF FOREIGN BANKS

9 SEC. 228. Section 18(j)(2) of the Federal Deposit Insur-
10 ance Act (12 U.S.C. 1828(j)(2)) is amended by adding at the
11 end thereof the following: "The provisions of this subsection
12 shall not apply to any foreign bank, as defined in section
13 1(b)(7) of Public Law 95-369 (12 U.S.C. 3101(7)) having an
14 insured branch in the United States, but shall apply to the
15 insured branch."

16 TECHNICAL AMENDMENTS

17 SEC. 229. (a) Section 107(a)(1) of the Financial Institu-
18 tions Regulatory and Interest Rate Control Act of 1978 is
19 amended by striking out "Section 8(b)" and inserting in lieu
20 thereof "Sections 8(b)(1) and 8(b)(2)" and by striking out
21 "(12 U.S.C. 1818(b)) is" and inserting in lieu thereof "(12
22 U.S.C. 1818(b)(1) and (b)(2)) are".

23 (b) Section 205(2) of the Depository Institution Manage-
24 ment Interlocks Act (12 U.S.C. 3204(2)) is amended by
25 striking "25A" and inserting in lieu thereof "25(a)".

REMOVAL AUTHORITY

1

2 SEC. 230. (a) Section 5(d) of the Home Owners' Loan
3 Act, as amended (12 U.S.C. 1464(d)) is amended—

4 (1) by redesignating paragraphs (4) (C) through
5 (E) as paragraphs (4) (D) through (F), respectively, and
6 inserting after paragraph (4)(B) the following new
7 paragraph:

8 “(C) Whenever, in the opinion of the Board, any
9 director or officer of an association has committed a
10 violation of the Depository Institution Management In-
11 terlocks Act (12 U.S.C. 33201 et seq.), the Board may
12 serve upon such director or officer a written notice of
13 its intention to remove him from office or to prohibit
14 his further participation in any manner in the conduct
15 of the affairs of the association.”;

16 (2) by striking out “(A) or (B)” each place it ap-
17 pears in paragraphs (4)(D) and (4)(F), as redesignated,
18 and inserting in lieu thereof “(A), (B), or (C)”;

19 (3) by striking out “(E)” in the second sentence of
20 paragraph (4)(D), as redesignated, and inserting in lieu
21 thereof “(F)”;

22 (4) by striking out “(C)” in paragraph (F), as re-
23 designating, and inserting in lieu thereof “(D)”;

24 (5) by striking out in paragraph (5)(A), “or (C)”
25 and inserting in lieu thereof “(C) or (D)”;

1 (6) by striking out in paragraph (12)(A), “(C),
2 (4)(D)” and inserting in lieu thereof “(D), (4)(E)”.

3 (b)(1) Section 407(g) of the National Housing Act (12
4 U.S.C. 1730(g)) is amended—

5 (A) by redesignating paragraphs (3) through (5) as
6 paragraphs (4) through (6), respectively, and inserting
7 after paragraph (2) the following new paragraph:

8 “(3) Whenever, in the opinion of the Corporation,
9 any director or officer of an insured institution has
10 committed a violation of the Depository Institution
11 Management Interlocks Act (12 U.S.C. 3201 et seq.),
12 the Corporation may serve upon such director or offi-
13 cer a written notice of its intention to remove him from
14 office or to prohibit his further participation in any
15 manner in the conduct of the affairs of the institu-
16 tion.”;

17 (B) by striking out “or (2)” each place it appears
18 in paragraphs (4) and (6), as redesignated, and insert-
19 ing in lieu thereof “, (2) or (3)”;

20 (C) by striking out “(5)” in paragraph (4), as re-
21 designated, and inserting in lieu thereof “(6)”;

22 (D) by striking out “(3)” in paragraph (6), as re-
23 designated, and inserting in lieu thereof “(4)”.

24 (2) Section 407(h) of the National Housing Act (12
25 U.S.C. 1730(h)) is amended by striking out in paragraph

1 (h)(1), "or (3)" in the fourth sentence and inserting in lieu
2 thereof "(3) or (4)".

3 (3) Section 407(p)(1) of the National Housing Act (12
4 U.S.C. 1730(p)(1)) is amended by striking out "(g)(3), (g)(4),"
5 and inserting in lieu thereof "(g)(4), (g)(5),".

6 (c)(1) Section 206(g) of the Federal Credit Union Act, as
7 amended (12 U.S.C. 1786(g)) is amended—

8 (A) by redesignating paragraphs (3) through (5) as
9 paragraphs (4) through (6), respectively, and inserting
10 after paragraph (2) the following new paragraph:

11 "(3) Whenever, in the opinion of the Board, any
12 director, officer, or committee member of an insured
13 credit union has committed any violation of the De-
14 pository Institution Management Interlocks Act (12
15 U.S.C. 3201 et seq.), the Board may serve upon such
16 director, officer, or committee member a written notice
17 of its intention to remove him from office.";

18 (B) by striking out "or (2)" each place it appears
19 in paragraphs (4) or (6), as redesignated, and inserting
20 in lieu thereof ", (2), or (3)";

21 (C) by striking out "(5)" in paragraph (4), as re-
22 designated, and inserting in lieu thereof "(6)"; and

23 (D) by striking out "(3)" in paragraph (6), as re-
24 designated, and inserting in lieu thereof "(4)".

1 (2) Section 206(k) of the Federal Credit Union Act (12
2 U.S.C. 1786(k)) is amended by striking out “(3), (g)(4)” and
3 inserting in lieu thereof “(4), (g)(5)”.

4 (d)(1) Section 8(e) of the Federal Deposit Insurance Act
5 (12 U.S.C. 1818(e)) is amended—

6 (A) by redesignating paragraphs (3) through (5) as
7 paragraphs (4) through (6), respectively, and by adding
8 at the end of paragraph (2) the following new para-
9 graph:

10 “(3) Whenever, in the opinion of the appropriate
11 Federal banking agency, any director or officer of an
12 insured bank has committed any violation of the De-
13 pository Institution Management Interlocks Act (12
14 U.S.C. 3201 et seq.), the agency may serve upon such
15 director or officer a written notice of its intention to
16 remove him from office.”; and

17 (B) by striking out “or (2)” each place it appears
18 in paragraph (4), as redesignated, and inserting in lieu
19 thereof “, (2), or (3)”.

20 (2) Section 8(f) of the Federal Deposit Insurance Act
21 (12 U.S.C. 1818(f)) is amended by striking out “(e)(5) or
22 (e)(7)” and “(e)(1), (e)(3) or (e)(7)” and inserting in lieu there-
23 of “(e)(4) or (e)(5)” and “(e)(1), (e)(2), (e)(3), or (e)(5)”, re-
24 spectively.

1 (3) Section 8(g)(1) of the Federal Deposit Insurance Act
2 (12 U.S.C. 1818(g)(1)) is amended by striking out “or (3)” in
3 the penultimate sentence and inserting in lieu thereof “, (3),
4 or (4)”.

5 (4) Section 8(j) of the Federal Deposit Insurance Act
6 (12 U.S.C. 1818(j)) is amended by striking out “(e)(3),
7 (e)(4),” and inserting in lieu thereof “(e)(4), (e)(5),”.

8 **REPORTING REQUIREMENT**

9 SEC. 231. Section 106(b)(2) of the Bank Holding Com-
10 pany Act Amendments of 1970 (12 U.S.C. 1972(2)) is
11 amended—

12 (1) by inserting in subparagraph (G)(i) the phrase
13 “(other than either a foreign bank having an insured
14 branch or the insured branch of a foreign bank)” after
15 the term “insured bank”;

16 (2) by striking out in subparagraph (G)(i) the
17 phrase “such executive officer or shareholder has out-
18 standing an extension of credit” and inserting in lieu
19 thereof “there is outstanding an indebtedness to such
20 executive officer or person or to any company or politi-
21 cal or campaign committee controlled by such officer or
22 person”;

23 (3) by striking out in subparagraph (G)(i) the term
24 “corresponding” and inserting in lieu thereof “corre-
25 spondent”;

1 (4) by striking out in subparagraph (G)(i)(2) the
2 term “ten” and inserting in lieu thereof “thirty”;

3 (5) by inserting in subparagraph (G)(iii) the phrase
4 “(other than either a foreign bank having an insured
5 branch or the insured branch of a foreign bank)” after
6 the term “Each insured bank” and by inserting “of
7 section 7” after the words “subsection (k)(1)”; and

8 (6) by striking out in subparagraph (G) the terms
9 “stockholder of record”, “stockholder”, and “share-
10 holder” in each case where they appear and inserting
11 in lieu thereof the term “person” and by striking the
12 terms “stockholders of records” and “stockholders” in
13 each case where they appear and inserting in lieu
14 thereof the term “persons”.

15 DISCLOSURE OF MATERIAL FACTS

16 SEC. 232. Section 7(k)(1) of the Federal Deposit Insur-
17 ance Act (12 U.S.C. 1817(k)(1)) is amended by inserting the
18 phrase “(other than either a foreign bank having an insured
19 branch or the insured branch of a foreign bank)” after the
20 term “Each insured bank”, by striking the term “stockholder
21 of record” each time it appears and inserting the term
22 “person” in lieu thereof, and by striking the term “stockhold-
23 ers of record” and “stockholders” each time they appear and
24 inserting in lieu thereof the term “persons”.

1 **TECHNICAL AMENDMENT**

2 **SEC. 233.** Section 1006(b)(2) of the Federal Financial
3 Institutions Examination Council Act of 1978 (12 U.S.C.
4 3305) is amended by striking the term "unaccepted" and in-
5 serting the term "unacceptable" in lieu thereof.

6 **TITLE III—SECURITIES ACTIVITIES**7 **GLASS-STEAGALL AMENDMENT**

8 **SEC. 301.** (a) Paragraph seventh of section 5136 of the
9 Revised Statutes of the United States (12 U.S.C. 24) is
10 amended by adding at the end thereof the following: "The
11 limitations and restriction contained in this paragraph as to
12 dealing in and underwriting investment securities shall not
13 apply to all other nongeneral obligations issued or guaranteed
14 by or on behalf of a State or any political subdivision thereof
15 (except special assessment obligations and industrial revenue
16 bonds) which are at the time eligible for purchase by a na-
17 tional bank for its own account, except that (1) no association
18 shall hold such obligations of any one obligor or maker as a
19 result of underwriting, dealing, or purchasing for its own ac-
20 count (and for this purpose obligations as to which it is under
21 commitment shall be deemed to be held by it) in a total
22 amount exceeding at any one time 10 per centum of its capi-
23 tal stock actually paid in and unimpaired and 10 per centum
24 of its unimpaired surplus fund, (2) the purchase of such obli-
25 gations by a national bank as fiduciary from such bank as an

1 underwriter or dealer shall not be permitted unless lawfully
2 directed by court order, (3) no association may purchase such
3 obligations as fiduciary from a member of a syndicate in
4 which such association is participating until the syndicate has
5 closed as to underwriting, (4) any sales of such obligations by
6 an association to any of its depositors or borrowers or to any
7 correspondent bank (whether for such bank's own account or
8 as trustee) must be accompanied by a disclosure in writing to
9 the purchaser that the association is selling as an underwriter
10 or dealer, and (5) the purchase, during the underwriting
11 period, of any such obligations by an association for its own
12 investment account, from such association's own account
13 acting as underwriter, dealer, or trader, or from any entity
14 affiliated with such association within the meaning of subsec-
15 tion (b)(1) of section 2 of the Banking Act of 1933, as amend-
16 ed (12 U.S.C. 221a(b)(1)), shall not be permitted: *Provided,*
17 That this restriction shall not apply to any purchases by an
18 association for its investment account or accounts of any such
19 obligations (A) it alone has underwritten or (B) directly from
20 the underwriting syndicate or member thereof in which it is a
21 participant, or to associations not in the underwriting syndi-
22 cate. For purposes of this paragraph, the term 'industrial rev-
23 enue bond' shall mean an obligation, not secured by the full
24 faith and credit of the issuer, payable solely from the rentals
25 received by the issuer from private entities."

1 (b) The Secretary of the Treasury shall submit an
2 annual report to the Congress showing the extent to which
3 the business of underwriting and dealing in State and local
4 obligations is being carried on by commercial banks as com-
5 pared with other banking institutions with a view to deter-
6 mining the effect of the amendment made by subsection (a) on
7 the institutional distribution of such business. As used herein,
8 the term "State and local obligations" means obligations
9 issued or guaranteed by or on behalf of a State, political sub-
10 division of a State, or an agency of a State or political subdi-
11 vision thereof.

12 **AMENDMENT TO THE INVESTMENT COMPANY ACT OF 1940**

13 **SEC. 302.** Section 22 of the Investment Company Act
14 of 1940 is amended by adding at the end thereof the follow-
15 ing:

16 “(h)(1) Notwithstanding paragraph ‘Seventh’ of section
17 5136 of the Revised Statutes (12 U.S.C. 24), the twentieth
18 paragraph of section 9 of the Federal Reserve Act (12
19 U.S.C. 335), sections 20, 21, or 32 of the Banking Act of
20 1933 (12 U.S.C. 377, 378, or 78), or the Bank Holding
21 Company Act of 1956 (12 U.S.C. 1841 et seq.), a bank, a
22 bank holding company or a subsidiary thereof, a savings and
23 loan association, a savings bank, or a credit union—

24 “(A) may organize, sponsor, operate, control, or
25 render investment advice to an investment company

1 (including a company which would be an investment
2 company except for the provisions of section 3(c)(1) of
3 this title); or

4 “(B) may underwrite, distribute, sell, or issue se-
5 curities of any investment company if the officers and
6 employees of the banks, savings banks, savings and
7 loan associations, or credit unions who sell or issue
8 such securities meet such standards with respect to
9 training, experience, and sales practices as the agen-
10 cies referred to in paragraphs (2) and (3), in consulta-
11 tion with the Federal Financial Institutions Examina-
12 tion Council, shall prescribe by regulations.

13 “(2) Compliance with the standards established under
14 paragraph (1)(B) shall be enforced under—

15 “(A) section 8 of the Federal Deposit Insurance
16 Act, in the case of—

17 “(i) national banks, by the Comptroller of the
18 Currency;

19 “(ii) member banks of the Federal Reserve
20 System (other than national banks), by the Board
21 of Governors of the Federal Reserve System;

22 “(iii) banks and savings banks insured by the
23 Federal Deposit Insurance Corporation (other
24 than members of the Federal Reserve System), by



1 the Board of Directors of the Federal Deposit In-
- 2 surance Corporation;

3 “(B) section 5(d) of the Home Owners’ Loan Act
4 of 1933, section 407 of the National Housing Act, and
5 section 17 of the Federal Home Loan Bank Act, by
6 the Federal Home Loan Bank Board (acting directly or
7 through the Federal Savings and Loan Insurance Cor-
8 poration), in the case of any institution subject to any
9 of those provisions; and

10 “(C) the Federal Credit Union Act, by the Na-
11 tional Credit Union Administration Board with respect
12 to any federally insured credit union.

13 “(3) For the purpose of the exercise by any agency re-
14 ferred to in paragraph (2) of its powers under any Act re-
15 ferred to in that subsection, a failure to meet any standard
16 prescribed under paragraph (1)(A) of this subsection shall be
17 deemed to be a violation of a requirement imposed under that
18 Act. In addition to its powers under any provision of law
19 specifically referred to in paragraph (2), each of the agencies
20 referred to in that subsection may exercise, for the purpose of
21 enforcing compliance with any such standard, any other au-
22 thority conferred on it by law. Except to the extent that en-
23 forcement of such standards is specifically committed to some
24 other Government agency under paragraph (2), the Securities
25 and Exchange Commission shall enforce such standards.

1 “(4) A savings and loan association, savings bank, or
2 credit union shall not be deemed to be a ‘broker’ or ‘dealer’,
3 as those terms are used in the Securities Exchange Act of
4 1934, by reason of its engaging in any of the functions de-
5 scribed in this subsection.

6 “(5) As used in this subsection, the terms ‘bank holding
7 company’ and ‘subsidiary’ with respect to a bank holding
8 company have the meanings given them in section 2 of the
9 Bank Holding Company Act of 1956.”.

10 TITLE IV—USURY PROVISIONS

11 SHORT TITLE

12 SEC. 401. This title may be cited as the “Credit Dereg-
13 ulation and Availability Act of 1981”.

14 BUSINESS AND AGRICULTURAL CREDIT

15 SEC. 402. (a) Section 511 of the Depository Institutions
16 Deregulation and Monetary Control Act of 1980 (94 Stat.
17 161; Public Law 96-221) is amended to read as follows:

18 “SEC. 511. (a) The provisions of the constitution or the
19 laws of any State prohibiting, restricting, or in any way limit-
20 ing the rate, nature, type, amount of, or the method of calcu-
21 lating or providing or contracting for interest, discount
22 points, a time price differential, finance charges or other fees
23 or charges that may be charged, taken, received, or reserved
24 shall not apply in the case of business or agricultural credit.

1 “(b) ‘Agricultural credit’ means credit extended primar-
2 ily for agricultural purposes to a person that cultivates,
3 plants, propagates, or nurtures an agricultural product. ‘Ag-
4 ricultural purposes’ include the production, harvest, exhibi-
5 tion, marketing, transportation, processing, or manufacturing
6 of an agricultural product and the acquisition of farmland,
7 real property with a farm residence and personal property
8 and services used primarily in farming. ‘Agricultural product’
9 includes agricultural, horticultural, viticultural, and dairy
10 products, livestock, wildlife, poultry, bees, forest products,
11 fish and shellfish and any products thereof, including proc-
12 essed and manufactured products and any and all products
13 raised or produced on farms and any processed or manufac-
14 tured products thereof.

15 “(c) ‘Business credit’ means credit extended primarily
16 for business or commercial purposes, including investment,
17 and any credit extended to a person other than a natural
18 person.

19 “(d) ‘Credit’ includes all secured and unsecured loans,
20 credit sales, forbearances, advances, renewals and other ex-
21 tensions of credit.”.

22 (b) Section 512 of the Depository Institutions Deregula-
23 tion and Monetary Control Act of 1980 is amended to read as
24 follows:

1 “SEC. 512. (a) Except as provided in subsection (b) of
2 this section, the provisions of this part shall apply with re-
3 spect to business and agricultural credit extended on or after
4 April 1, 1980.

5 “(b) The provisions of this part shall not apply to any
6 business or agricultural credit extended in any State after the
7 effective date (if such effective date occurs on or after April
8 1, 1980, and prior to three years after the effective date of
9 the Credit Deregulation and Availability Act of 1981) of a
10 State law or a certification that the voters of such State have
11 voted in favor of any provision, constitutional or otherwise,
12 which states explicitly and by its terms that such State does
13 not want the provisions of this part to apply with respect to
14 credit extensions subject to the laws of such State, except
15 that such provisions shall apply to any credit extended on or
16 after such date pursuant to a commitment to extend such
17 credit which was entered into on or after April 1, 1980, and
18 prior to such later date.

19 “(c) Credit shall be deemed to be extended during the
20 period to which this provision applies if such credit exten-
21 sion—

22 “(1)(A)(i) is funded or made in whole or in part
23 during such period, regardless of whether pursuant to a
24 commitment or other agreement therefor made prior to
25 April 1, 1980;

1 “(ii) was made prior to or on April 1, 1980, and
2 bears or provides for interest during such period on the
3 outstanding amount thereof at a variable or fluctuating
4 rate; or

5 “(iii) is a renewal, extension, or other modification
6 of an extension of credit made prior to April 1, 1980,
7 and such renewal or extension or other modification is
8 made during such period with the written consent of
9 any person obligated to repay such credit; and

10 “(B)(i) has an original principal amount of
11 \$25,000 or more (\$1,000 or more on or after the date
12 of enactment of the Housing and Community Develop-
13 ment Act of 1980 or any amount on or after the date
14 of enactment of the Credit Deregulation and Availabil-
15 ity Act of 1981); or

16 “(ii) is part of a series of advances if the aggre-
17 gate of all sums advanced or agreed or contemplated to
18 be advanced pursuant to a commitment or other agree-
19 ment therefor is \$25,000 or more (\$1,000 or more on
20 or after the date of enactment of the Housing and
21 Community Development Act of 1980 or any amount
22 on or after the date of enactment of the Credit Dereg-
23 ulation and Availability Act of 1981); or

24 “(2) is a renewal, extension, other modification or
25 use of a credit agreement or extension made during

1 such period, including an agreement entered during
 2 that period that contemplates future extensions of
 3 credit from time to time in which the charges that are
 4 assessed for or in connection with credit are calculated
 5 from time to time, in whole or in part, on the basis of
 6 the outstanding balance and the credit is extended not
 7 later than eighteen months after the effective date of
 8 the State law or certification.”.

9 **CONSUMER CREDIT**

10 **SEC. 403.** Title V of the Depository Institutions Dereg-
 11 ulation and Monetary Control Act of 1980 (94 Stat. 161;
 12 Public Law 96-221) is amended by adding at the end thereof
 13 the following new subpart:

14 **“PART D—CONSUMER CREDIT**

15 **“SEC. 531.** The provisions of the constitution or laws of
 16 any State prohibiting, restricting, or in any way limiting the
 17 rate, nature, type, amount of, or the manner of calculating or
 18 providing or contracting for covered charges that may be
 19 charged, taken, received or reserved shall not apply to an
 20 extension of consumer credit made by a creditor.

21 **“SEC. 532. (a)** As used in this part, the terms set forth
 22 below shall be defined as follows:

23 **“(1) ‘Covered charges’ means—**

24 **“(A) interest, discount points, a time price**
 25 **differential, fees, charges or any other compensa-**

1 tion paid to the creditor or arising out of the
2 credit agreement or transaction for the use of
3 credit or credit services. The term shall not in-
4 clude, however, fees, charges or other amounts
5 paid to the creditor or arising out of the credit
6 agreement or transaction that are paid or arise
7 solely as the result of the failure or refusal of the
8 debtor to comply with the terms and conditions of
9 the debtor's agreement with the creditor; and

10 “(B) fees or charges paid for the availability
11 of credit, payment mechanism services, or for sim-
12 ilar purposes, including periodic, transaction and
13 access fees.

14 “(2) ‘Credit’ includes all secured and unsecured
15 loans, credit sales, forbearances, advances, renewals
16 and other extensions of credit, all without regard to the
17 nature of any property that might secure its repay-
18 ment.

19 “(3) ‘Creditor’ means any person that regularly
20 makes extensions of consumer credit, which, for pur-
21 poses of this definition, shall include extensions of cred-
22 it that are subject to the provisions of section 501(a) of
23 this title. A person is not a ‘creditor’ with respect to a
24 specific extension of consumer credit if, except for this
25 part, in order to assess or collect covered charges in

1 connection with that transaction, the person would be
2 required to comply with licensing requirements imposed
3 under State law, unless such person is licensed under
4 applicable State law and such person remains, or be-
5 comes, subject to the applicable regulatory require-
6 ments and enforcement mechanisms provided by State
7 law.

8 “(4) ‘Extension of consumer credit’ means any
9 credit extended to a natural person primarily for per-
10 sonal, family, or household purposes, except that it
11 does not include credit subject to the provisions of sec-
12 tion 501(a) of this title.

13 “SEC. 533. (a) Except as provided in subsection (b) of
14 this section, the provisions of section 531 shall apply with
15 respect to any extension of consumer credit made by a credi-
16 tor on or after the effective date of the Credit Deregulation
17 and Availability Act of 1981.

18 “(b)(1) The provisions of section 531 shall not apply to
19 any extension of consumer credit in any State made on or
20 after the effective date (if such effective date occurs on or
21 after the effective date of the Credit Deregulation and Avail-
22 ability Act of 1981 and prior to a date three years after such
23 effective date) of a State law or a certification that the voters
24 of such State have voted in favor of any provision, constitu-
25 tional or otherwise, which states explicitly and by its terms

1 that such State does not want the provisions of this part to
2 apply with respect to extensions of consumer credit subject to
3 the laws of such State, except that such provisions shall
4 apply to any consumer credit extended on or after such date
5 pursuant to an agreement to extend such credit which was
6 entered into on or after the effective date of the Credit De-
7 regulation and Availability Act of 1981 and prior to such
8 later date.

9 “(2) Credit shall be deemed to have been extended
10 during the period to which this provision applies, if it—

11 “(A) is funded or extended in whole or in part
12 during such period, regardless of whether pursuant to a
13 commitment or other agreement therefor made prior to
14 that period;

15 “(B) was made prior to such period and bears or
16 provides for covered charges that may vary or fluctu-
17 ate during that period;

18 “(C) is a renewal, extension, or other modification
19 of a credit extension made before such period and such
20 renewal, extension or other modification is made
21 during such period with the written consent of any
22 person obligated to repay such credit; or

23 “(D) is extended in accordance with an agreement
24 entered during that period that contemplates future ex-
25 tensions of consumer credit from time to time in which

1 the covered charges are calculated from time to time,
2 in whole or in part, on the basis of the outstanding bal-
3 ance and the credit is extended not later than eighteen
4 months after the effective date of the State law or cer-
5 tification.

6 “(c) Any law or certification adopted by a State or its
7 voters pursuant to subsection (b) of this section may specify
8 that portion of the extensions of consumer credit made in
9 such State, or those types or kinds of covered charges, to
10 which the provisions of section 531 will not apply.

11 “SEC. 534. The Board of Governors of the Federal Re-
12 serve System is authorized to publish Board interpretations
13 regarding the scope and application of section 531 of this
14 part. Upon its own motion or upon the request of any credi-
15 tor, State, or other interested party which is submitted to the
16 Board in accordance with procedures it establishes, within
17 sixty days the Board shall issue an official interpretation re-
18 garding the scope of section 531 and its relationship to spe-
19 cific provisions of State law, or shall make public a Board
20 determination (accompanied by an appropriate explanation)
21 that the question presented does not involve a significant
22 issue or does not affect a substantial number of creditors or
23 extensions of consumer credit.”.

1 **FEDERAL CREDIT UNIONS**

2 **SEC. 404.** Section 1757(5)(A)(vi) of the Federal Credit
3 Union Act is amended to read as follows: “rates of interest
4 shall be established by the board of directors of the Federal
5 credit union;”.

6 **TITLE V—CREDIT UNIONS**7 **CREDIT UNION MERGERS**

8 **SEC. 501.** Section 205 of the Federal Credit Union Act
9 (12 U.S.C. 1785) is amended—

10 (1) by redesignating subsections (d) through (g) as
11 subsections (f) through (j), respectively; and

12 (2) by inserting after subsection (c) the following:

13 “(d) Notwithstanding any other provision of this Act,
14 other Federal law or any State law, the Board may authorize
15 a merger or consolidation of an insured credit union which is
16 insolvent or is in danger of insolvency with any other insured
17 credit union or may authorize a purchase and assumption by
18 an insured credit union of all or any part of the assets and
19 liabilities of any other insured credit union which is insolvent
20 or in danger of insolvency if the Board is satisfied that an
21 emergency requiring expeditious action exists with respect to
22 the credit union, that other alternatives are not reasonably
23 available, and that the public interest would best be served
24 by approval of such merger, consolidation, or purchase and
25 assumption.

CLF

18 “(f) In addition to the authority to borrow from the Sec-
19 retary of the Treasury provided in subsection (d), if in the
20 judgment of the Board, a loan to the fund is required at any
21 time for carrying out the purposes of this title, the fund is
22 authorized to borrow from the National Credit Union Admin-
23 istration Central Liquidity Facility.”.

CLF INVESTMENT AUTHORITY

1 SEC. 503. Section 307(a) of the Federal Credit Union
2 Act (12 U.S.C. 1795f(a)) is amended—

3 (1) by striking out “and” at the end of paragraph
4 (15);

5 (2) by striking out the period at the end of para-
6 graph (16) and inserting in lieu thereof a semicolon;
7 and

8 (3) by adding at the end thereof the following:

9 “(17) make loans not to exceed thirty days in ma-
10 turity to banks and other financial institutions and ac-
11 quire financial assets for the purpose of effective cash
12 management;

13 “(18) to exercise such incidental powers as shall
14 be necessary or requisite to enable it to carry out ef-
15 fectively the purposes for which the Facility is incorpo-
16 rated; and

17 “(19) advance funds to the National Credit Union
18 Share Insurance Fund under such terms and conditions
19 as may be established by the Board.”.

CLF TAX EXEMPTION

20 SEC. 504. (a) Title III of the Federal Credit Union Act
21 (12 U.S.C. 1751 et seq.) is amended by adding at the end
22 thereof the following new section:

1 **"TAX EXEMPTION**

2 **"SEC. 311. (a) The Central Liquidity Facility, its fran-**
3 **chise, activities, capital, reserves, surplus, and income shall**
4 **be exempt from all Federal, State, and local taxation now or**
5 **hereafter imposed, other than taxes on real property held by**
6 **the Facility (to the same extent, according to its value, as**
7 **other similar property held by other persons is taxed).**

8 **"(b) The notes, bonds, debentures, and other obligations**
9 **issued on behalf of the Central Liquidity Facility and the**
10 **income therefrom shall be exempt from all Federal, State,**
11 **and local taxation now or hereafter imposed, other than—**

12 **"(1) the Federal income tax liability of the holders**
13 **thereof; and**

14 **"(2) Federal, State, and local gift, estate, inheri-**
15 **tance, legacy, succession, and other wealth transfer**
16 **taxes.**

17 **"(c) For purposes of this section—**

18 **"(1) the term 'State' includes the District of Co-**
19 **lumbia; and**

20 **"(2) taxes imposed by counties or municipalities,**
21 **or any territory, dependency, or possession of the**
22 **United States shall be treated as local taxes."**

23 **(b) The amendment made by subsection (a) shall take**
24 **effect on October 1, 1979.**

1 **CLF AS AGENT OF FEDERAL RESERVE SYSTEM**

2 **SEC. 505.** Title III of the Federal Credit Union Act (12
3 U.S.C. 1795 through 1795i) is amended by adding at the end
4 thereof the following:

5 **"AGENT OF THE FEDERAL RESERVE SYSTEM**

6 **"SEC. 312.** The Facility is authorized to act upon the
7 request of the Board of Governors of the Federal Reserve
8 System as an agent of the Federal Reserve System in mat-
9 ters pertaining to credit unions under such terms and condi-
10 tions as may be established by the Federal Reserve Board."

11 **NCUA CONSERVATORSHIP AUTHORITY**

12 **SEC. 506.** (a) Section 206 of the Federal Credit Union
13 Act (12 U.S.C. 1786) is amended by redesignating subsec-
14 tions (h) through (o) as subsections (i) through (p), respective-
15 ly, and by inserting after subsection (g) the following new
16 subsection:

17 **"(h)(1)** The Board may, ex parte and without notice,
18 appoint itself as conservator and immediately take possession
19 and control of the business and assets of any insured credit
20 union in any case in which—

21 **"(A)** the Board determines that such action is
22 necessary to conserve the assets of any insured credit
23 union or to protect the Fund or the interests of the
24 members of such insured credit union; or

1 “(B) an insured credit union, by a resolution of its
2 board of directors, consents to such an action by the
3 Board.

4 “(2) Not later than ten days after the date on which the
5 Board takes possession and control of the business and assets
6 of an insured credit union pursuant to paragraph (1), such
7 insured credit union may apply to the United States district
8 court for the judicial district in which the principal office of
9 such insured credit union is located, or the United States
10 District Court for the District of Columbia, for an order re-
11 quiring the Board to show cause why it should not be en-
12 joined from continuing such possession and control.

13 “(3) Except as provided in paragraph (2), in the case of
14 a Federal credit union, the Board may maintain possession
15 and control of the business and assets of such credit union
16 and may operate such credit union until such time—

17 “(A) as the Board shall permit such credit union
18 to continue business, subject to such terms and condi-
19 tions as may be imposed by the Board; or

20 “(B) as such credit union is liquidated in accord-
21 ance with the provisions of section 207.

22 “(4) Except as provided in paragraph (2), in the case of
23 an insured State-chartered credit union, the Board may
24 maintain possession and control of the business and assets of

1 such credit union and may operate such credit union until
2 such time—

3 “(A) as the Board shall permit such credit union
4 to continue business, subject to such terms and condi-
5 tions as may be imposed by the Board;

6 “(B) as the Board shall permit the transfer of pos-
7 session and control of such credit union to any commis-
8 sion, board, or authority which has supervisory author-
9 ity over such credit union and which is authorized by
10 State law to operate such credit union; or

11 “(C) as such credit union is liquidated in accord-
12 ance with the provisions of section 207.

13 “(5) The Board may appoint such agents as it considers
14 necessary in order to assist the Board in carrying out its
15 duties as a conservator under this subsection.

16 “(6) All expenses incurred by the Board in exercising its
17 authority under this subsection with respect to any credit
18 union shall be paid out of the assets of such credit union.

19 “(7) The authority granted by this subsection is in addi-
20 tion to all other authority granted to the Board under this
21 Act.”.

22 (b) Section 206(b)(2) of such Act (12 U.S.C. 1786(b)(2))
23 is amended by striking out “subsection (i)” and inserting in
24 lieu thereof “subsection (j)”.

1 (c) Section 206(j)(1) of such Act (12 U.S.C. 1786(j)(1)),
 2 as so redesignated by subsection (a), is amended—

3 (1) in the first sentence by striking out “subsec-
 4 tion (h)(3)” and inserting in lieu thereof “subsection
 5 (i)(3)”; and

6 (2) in the fourth sentence, by striking out “sub-
 7 section (i)” and inserting in lieu thereof “subsection
 8 (j)”.

9 (d) The first sentence of section 206(j)(2) of such Act (12
 10 U.S.C. 1786(j)(2)), as so redesignated by subsection (a) is
 11 amended by striking out “subsection (h)(1)” and inserting in
 12 lieu thereof “subsection (i)(1)”.

13 (e) The first sentence of section 206(l) of such Act (12
 14 U.S.C. 1786(l)), as so redesignated by subsection (a) is
 15 amended by striking out “(h)” and inserting in lieu thereof
 16 “(i)”.

17 (f) Section 206(m) of such Act (12 U.S.C. 1786(m)), as
 18 so redesignated by subsection (a), is amended—

19 (1) by striking out “subsection (i)” and inserting
 20 in lieu thereof “subsection (j)”; and

21 (2) by striking out “subsection (h)” and inserting
 22 in lieu thereof “subsection (i)”.

23 (g) The section heading for section 206 of the Federal
 24 Credit Union Act (12 U.S.C. 1786) is amended by inserting

1 “; TAKING POSSESSION OF BUSINESS AND ASSETS” after
2 “COMMITTEE MEMBERS”.

3 REMOVAL OF CALENDAR YEAR REQUIREMENT FOR AUDIT

4 SEC. 507. Section 102(f) of the Federal Credit Union
5 Act (12 U.S.C. 1752a(f)) is amended by striking the words
6 “on a calendar year basis”.

7 ELIMINATION OF REQUIREMENT FOR PARTIAL YEAR

8 PREMIUM AND REBATES

9 SEC. 508. Section 202(c) of the Federal Credit Union
10 Act (12 U.S.C. 1782(c)) is amended by—

- 11 (1) striking out paragraphs (3) and (6); and
12 (2) redesignating paragraphs (4) and (5) as para-
13 graphs (3) and (4), respectively.

14 INVESTMENT OF NCUA OPERATING FUNDS

15 SEC. 509. Section 105 of the Federal Credit Union Act
16 (12 U.S.C. 1755) is amended by adding at the end thereof
17 the following new subsection:

18 “(e)(1) Upon request of the Board, the Secretary of the
19 Treasury shall invest and reinvest such portions of the annual
20 operating fees deposited under subsection (d) as the Board
21 determines are not needed for current operations.

22 “(2) Such investments and reinvestments may be made
23 only in—

24 “(A) interest-bearing securities of the United
25 States;

1 “(B) securities guaranteed as to both principal and
2 interest by the United States; or

3 “(C) bonds, securities, or other obligations of the
4 United States which are lawful investments for fidu-
5 ciary, trust, and public funds of the United States.

6 “(3) All income derived from such investments and rein-
7 vestments shall be deposited to the account of the Adminis-
8 tration described in subsection (d).”.

9 **MATURITY LIMIT OF FIRST MORTGAGE LOANS**

10 **SEC. 510.** Section 107(5)(A)(i) of the Federal Credit
11 Union Act (12 U.S.C. 1757(5)(A)(i)) is amended by inserting
12 “or such other limits as shall be set by the NCUA Board”
13 after “not exceeding thirty years”.

14 **REMOVAL OF MEDIAN SALES PRICE REQUIREMENT**

15 **SEC. 511.** Section 107(5)(A)(i) of the Federal Credit
16 Union Act (12 U.S.C. 1757(5)(A)(i)) is amended by striking
17 out “the sales price of which is not more than 150 per
18 centum of the median sales price of residential real property
19 situated in the geographical area (as determined by the board
20 of directors) in which the property is located,”.

21 **REFINANCING**

22 **SEC. 512.** Section 107(5)(A)(i) of the Federal Credit
23 Union Act (12 U.S.C. 1757(5)(A)(i)) is amended by striking
24 out “which is made to finance the acquisition of” and insert-
25 ing in lieu thereof “on” and by striking out the word “for”

1 the first time it appears in that section and inserting in lieu
2 thereof "that is or will be".

3 **SECOND MORTGAGE LOANS**

4 **SEC. 513.** Section 107(5)(A)(ii) of the Federal Credit
5 Union Act (12 U.S.C. 1757(5)(A)(ii)) is amended by striking
6 out "or for the repair, alteration, or improvement of a resi-
7 dential dwelling which is the residence of a credit union
8 member" and inserting in lieu thereof "a second mortgage
9 loan secured by a residential dwelling which is the residence
10 of a credit union member".

11 **PROMPT CREDITING OF PREPAYMENTS**

12 **SEC. 514.** Section 107(5)(A)(viii) of the Federal Credit
13 Union Act (12 U.S.C. 1757(5)(A)(viii)) is amended by insert-
14 ing before the semicolon at the end thereof the following: "
15 except that on first or second mortgage loans a Federal credit
16 union may require that any partial prepayments (I) be made
17 on the date monthly installments are due, and (II) be in the
18 amount of that part of one or more monthly installments
19 which would be applicable to principal".

20 **INSURABILITY OF CUSTODIAL ACCOUNTS**

21 **SEC. 515.** Section 101(5) of the Federal Credit Union
22 Act (12 U.S.C. 1752(5)) is amended by inserting ", and such
23 terms mean custodial accounts established for loans sold in
24 whole or in part pursuant to section 107(13)" after "section
25 207 of this Act".

3 **SEC. 516.** Section 107(7)(E) of the Federal Credit
4 Union Act (12 U.S.C. 1757(7)(E)) is amended by inserting
5 before the semicolon the following: "or in obligations, partici-
6 pations, securities, or other instruments of, or issues by, or
7 fully guaranteed as to principal and interest by any other
8 agency of the United States and a Federal credit union may
9 issue and sell securities which are guaranteed pursuant to
0 section 306(g) of the National Housing Act".

12 SEC. 517. Section 118 of the Federal Credit Union Act
13 (12 U.S.C. 1764) is amended to read as follows:

15 “SEC. 118. (a) Except for those circumstances set out in
16 subsection (b) of this section, a member may be expelled by a
17 two-thirds vote of the members of a Federal credit union
18 present at a special meeting called for the purpose, but only
19 after opportunity has been given him to be heard.

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1 failure to purchase shares from, obtain a loan from, or lend to
2 the Federal credit union.

3 “(c) Withdrawal or expulsion of a member pursuant to
4 either subsection (a) or (b) of this section shall not operate to
5 relieve him from liability to the Federal credit union.”.

6 **TITLE VI—PROPERTY, CASUALTY, LIFE INSUR-**
7 **ANCE ACTIVITIES OF BANK HOLDING COM-**
8 **PANIES**

9 **SEC. 601.** Section 4(c)(8) of the Bank Holding Company
10 Act of 1956 (12 U.S.C. 1843(c)(8)) is amended by striking
11 out the period at the end of the first sentence and inserting in
12 lieu thereof the following: “, but for purposes of this subsec-
13 tion it is not closely related to banking or managing or con-
14 trolling banks for a bank holding company to provide insur-
15 ance as a principal, agent, or broker except (A) where the
16 insurance is limited to assuring repayment of the outstanding
17 balance due on a specific extension of credit by a bank hold-
18 ing company or its subsidiary in the event of the death, dis-
19 ability, or involuntary unemployment of the debtor and, in
20 the case of involuntary unemployment, where the coverage is
21 offered in connection with a bank credit card and the card-
22 holder is solicited to purchase the coverage after the credit
23 card has been issued by the creditor; (B) in the case of a
24 finance company which is a subsidiary of a bank holding com-
25 pany, where the insurance is also limited to assuring repay-

1 ment of the outstanding balance on an extension of credit in
2 the event of loss or damage to any property used as collateral
3 on such extension of credit and, during the period beginning
4 on the date of the enactment of this subparagraph and ending
5 on December 31, 1980, such extension of credit is not more
6 than \$10,000 (\$25,000 in the case of an extension of credit
7 which is made to finance the purchase of a residential manu-
8 factured home and which is secured by such residential man-
9 ufactured home) and for any given year after 1980, such ex-
10 tension of credit is not more than an amount equal to
11 \$10,000 (\$25,000 in the case of an extension of credit which
12 is made to finance the purchase of a residential manufactured
13 home and which is secured by such residential manufactured
14 home) increased by the percentage increase in the Consumer
15 Price Index for Urban Wage Earners and Clerical Workers
16 published monthly by the Bureau of Labor Statistics for the
17 period beginning on January 1, 1980, and ending on Decem-
18 ber 31 of the year preceding the year in which such extension
19 of credit is made; (C) any insurance agency activity in a place
20 that (i) has a population not exceeding five thousand (as
21 shown by the last preceding decennial census), or (ii) the
22 bank holding company, after notice and opportunity for a
23 hearing, demonstrates has inadequate insurance agency facil-
24 ities; (D) any insurance agency activity which was engaged
25 in by the bank holding company or any of its subsidiaries on

1 June 12, 1980, or which the Board approved for such com-
2 pany or any of its subsidiaries on or before June 12, 1980, or
3 which was covered by an application accepted for processing
4 on or before April 29, 1980, and approved after June 12,
5 1980, including (i) sales of insurance at new locations of the
6 same bank holding company or the same subsidiary or subsid-
7 iaries with respect to which insurance was sold on June 12,
8 1980, or approved to be sold on or before June 12, 1980, or
9 covered by an application accepted for processing on or
10 before April 29, 1980, and approved after June 12, 1980, if
11 such new locations are confined to the State in which the
12 principal place of business of the bank holding company is
13 located, any State or States immediately adjacent to such
14 State, and any State or States in which insurance activities
15 were conducted by the bank holding company or any of its
16 subsidiaries on June 12, 1980, or were approved to be con-
17 ducted by the bank holding company or any of its subsidiaries
18 on or before June 12, 1980, or were covered by an applica-
19 tion accepted for processing on or before April 29, 1980, and
20 were approved after June 12, 1980, and (ii) sales of insur-
21 ance coverages which may become available after June 12,
22 1980, so long as those coverages insure against the same
23 types of risks as, or are otherwise functionally equivalent to,
24 coverages sold on June 12, 1980, or approved to be sold on
25 or before June 12, 1980; (E) any insurance activity where

1 the activity is limited solely to supervising on behalf of insur-
 2 ance underwriters the activities of retail insurance agents
 3 who sell (i) fidelity insurance and property and casualty in-
 4 surance on the real and personal property used in the oper-
 5 ations of the bank holding company or any of its subsidiaries,
 6 and (ii) group insurance that protects the employees of the
 7 bank holding company or any of its subsidiaries; or (F) any
 8 insurance agency activity engaged in by a bank holding com-
 9 pany, or any of its subsidiaries, which bank holding company
 10 has total assets of \$50,000,000 or less: *Provided, however,*
 11 That such bank holding company and its subsidiaries may not
 12 engage in the sale of life insurance or annuities except as
 13 provided in subparagraph (A), (B), or (C).".

14 TITLE VII—MISCELLANEOUS

15 DEPOSIT INSURANCE OF RETIREMENT ACCOUNTS

16 SEC. 701. (a)(1) The first sentence of section 405(d)(3)
 17 of the National Housing Act (12 U.S.C. 1728(d)(3)) is
 18 amended by striking out "\$100,000" and inserting in lieu
 19 thereof "\$250,000".

20 (2) The first sentence of section 11(a)(3) of the Federal
 21 Deposit Insurance Act (12 U.S.C. 1821(a)(3)) is amended by
 22 striking out "\$100,000" and inserting in lieu thereof
 23 "\$250,000".

24 (3) The first sentence of section 207(c)(3) of the Federal
 25 Credit Union Act (12 U.S.C. 1787(c)(3)) is amended by strik-

1 ing out "\$100,000" and inserting in lieu thereof
2 "\$250,000".

3 (b) The amendments made by subsection (a) are not ap-
4 plicable to—

5 (1) any claim arising out of the closing of a bank
6 prior to the effective date of this section;

7 (2) any claim arising out of a default, as defined
8 in section 401(d) of the National Housing Act (12
9 U.S.C. 1724(d)), where the appointment of a conserva-
10 tor, receiver, or other legal custodian as set forth in
11 that section became effective prior to the effective date
12 of this section; or

13 (3) any claim arising out of the closing of a credit
14 union for liquidation on account of bankruptcy or insol-
15 vency pursuant to section 207 of the Federal Credit
16 Union Act (12 U.S.C. 1787) prior to the effective date
17 of this section.

18 INTERNATIONAL BANKING FACILITIES

19 SEC. 702. Paragraph (5) of section 3(l) of the Federal
20 Deposit Insurance Act (12 U.S.C. 1813(l)) is amended to
21 read as follows:

22 "(5) such other obligations of a bank as the Board
23 of Directors, after consultation with the Comptroller of
24 the Currency and the Board of Governors of the Fed-
25 eral Reserve System, shall find and prescribe by regu-

1 lation to be deposit liabilities by general usage, except
 2 that the following shall not be a deposit for any of the
 3 purposes of this Act and shall not be included as part
 4 of total deposits or of an insured deposit:

5 “(A) any obligation of a bank which is pay-
 6 able only at an office of the bank located outside
 7 of the States of the United States, the District of
 8 Columbia, Puerto Rico, Guam, American Samoa,
 9 and the Virgin Islands; and

10 “(B) any international banking facility depos-
 11 it, including an international banking facility time
 12 deposit as that term is from time to time defined
 13 by the Board of Governors of the Federal Reserve
 14 System in its regulation D or any successor regu-
 15 lation thereto.”.

16 DEFINITION OF CREDITOR

17 SEC. 703. Section 103(f) of the Truth in Lending Act
 18 (15 U.S.C. 1602(f)) is amended to read as follows:

19 “(f) The term ‘creditor’ refers only to a person who both
 20 (1) regularly extends, whether in connection with loans, sales
 21 of property or services, or otherwise, consumer credit which
 22 is payable by agreement in more than four installments or for
 23 which the payment of a finance charge is or may be required,
 24 and (2) is the person to whom the debt arising from the con-
 25 sumer credit transaction is initially payable on the face of the

1 evidence of indebtedness or, if there is no such evidence of
 2 indebtedness, by agreement. Notwithstanding the preceding
 3 sentence, in the case of an open end credit plan involving a
 4 credit card, the card issuer and any person who honors the
 5 credit card and offers a discount which is a finance charge
 6 are creditors. For the purpose of the requirements imposed
 7 under chapter 4 and section 127(a)(5), 127(a)(6), 127(a)(7),
 8 127(b)(1), 127(b)(2), 127(b)(3), 127(b)(8), and 127(b)(10) of
 9 chapter 2 of this title, the term 'creditor' shall also include
 10 card issuers whether or not the amount due is payable by
 11 agreement in more than four installments or the payment of a
 12 finance charge is or may be required, and the Board shall, by
 13 regulation, apply these requirements to such card issuers, to
 14 the extent appropriate, even though the requirements are by
 15 their terms applicable only to creditors offering open end
 16 credit plans."

17 RELATION TO STATE LAWS

18 SEC. 704. (a) Subsections (b), (c), and (d) of section 111
 19 of the Truth in Lending Act are redesignated as subsections
 20 (c), (d), and (e), respectively.

21 (b) Section 111 of the Truth in Lending Act (15 U.S.C.
 22 1610) is amended by inserting under the caption the follow-
 23 ing:

24 "(a)(1) Except as otherwise provided in this section, this
 25 title supersedes any State law that is similar in purpose,

1 scope, requirement, or content to this title, to the extent of
2 the similarity. Similar laws include, but are not limited to,
3 laws relating to the disclosure or advertising of consumer
4 credit or lease terms, credit card and credit billing practices,
5 liability for consumer lease transactions, and the rescission of
6 consumer credit transactions.

7 “(2) Upon its own motion, or upon the request of any
8 creditor, lessor, State, or other interested party, the Board
9 shall determine whether a State law is similar to this title,
10 and thereby superseded, and shall publish notice of such de-
11 termination.

12 “(b) The provisions of this title shall not apply to any
13 extension of consumer credit or any consumer lease in any
14 State which makes a determination that such provisions shall
15 not apply with respect to extensions of consumer credit and
16 consumer leases subject to the laws of such State. Such de-
17 termination must—

18 “(1) explicitly and by its terms indicate the provi-
19 sions of this title that shall not apply in such State;

20 “(2) occur on or after the date of enactment of
21 this Act and prior to a date three years after such
22 date;

23 “(3) provide for an effective date at least one year
24 subsequent to such determination and permit creditors

1 and lessors to comply with such determination prior to
2 such effective date; and

3 “(4) be transmitted to the Board, which shall pub-
4 lish notice of the State’s determination, upon a finding
5 that the State law complies with the requirements of
6 this subsection.”.

7 (c) Sections 123, 171, 186(a), and 186(b) of such Act
8 are repealed.

9 (d) Section 167 of such Act is amended by adding at the
10 end thereof the following:

11 “(c) Notwithstanding any other provisions of this title,
12 any discount offered under subsection (b) shall not be consid-
13 ered a finance charge or other charge for credit under the
14 usury laws of any State or under the laws of any State relat-
15 ing to disclosure of information in connection with credit
16 transactions, or relating to the types, amounts or rates of
17 charges, or to any element or elements of charges permissible
18 under such laws in connection with the extension or use of
19 credit.”.

20 **CIVIL LIABILITY**

21 **SEC. 705.** (a) Section 130(a) of the Truth in Lending
22 Act (15 U.S.C. 1640(a)) is amended to read as follows:

23 “(a) Except as otherwise provided in this section, a
24 creditor who fails to comply with any requirement imposed
25 under this chapter, including any requirement under section

1 125, or chapter 4 or 5 of this title with respect to any person
2 is liable to such person in an amount equal to the sum of

3 “(1) any actual damage sustained by such person
4 as a result of the failure;

5 “(2) in the case of an individual action an amount
6 not greater than \$5,000, and in the case of a corporation an
7 amount not greater than the lower of \$250,000 or 10
8 per centum of the net worth of the corporation if the
9 court finds that—

10 “(A) the creditor failed to comply with the re-
11 quirement of section 125; section 127(a) or (b) or para-
12 graph (4), (5), (6), (7), (8), (9), or (10) of section
13 127(b); paragraph (2) (insofar as it requires a filing
14 closure of the ‘amount financed’); or section 128(a), section 129
15 or (9) of section 128(a); section 132 or section 133
16 183; and

17 “(B) the creditor’s noncompliance with the requirements of
18 noncompliance with the requirements of section 125, or
19 except that, in determining the amount of damages under para-
20 graph, the court shall consider among other factors
21 factors, the amount of any noncompliance, the frequency and
22 the frequency and persistence of the noncompliance
23 by the creditor, the number of persons adversely affected
24 number of persons adversely affected by the noncompliance.

1 which the creditor's failure of compliance was inten-
2 tional; and

3 “(3) in the case of any successful action to enforce
4 the foregoing liability or in any action in which a
5 person is determined to have a right of rescission under
6 section 125, the costs of the action, together with a
7 reasonable attorney's fee as determined by the court.”.

8 (b) Section 130(d) of such Act is amended to read as
9 follows:

10 “(d)(1) When there are multiple obligors in a consumer
11 credit transaction or consumer lease, there shall be no more
12 than one recovery of damages under subsection (a)(2) for a
13 violation of this title.

14 “(2) With respect to any failure to make disclosures re-
15 quired under this chapter or chapter 4 or 5 of this title, liabil-
16 ity may be imposed only upon the creditor required to make
17 disclosure, except as provided in section 131.”.

18 (c) The last sentence of section 625(c) of Public Law 96-
19 221 is amended by inserting “and by section 705 of the Fi-
20 nancial Institutions Restructuring and Services Act of 1981”
21 before the period.

1 **EXTENSION OF TRUTH IN LENDING SIMPLIFICATION**2 **EFFECTIVE DATE**

3 **SEC. 706.** Section 625(a) of the Depository Institutions
4 Deregulation and Monetary Control Act of 1980 is amended
5 to read as follows:

6 “SEC. 625. (a) Except as provided in section 608(b), the
7 amendments made by this title shall take effect upon the ex-
8 piration of two years and six months after the date of enact-
9 ment of this title.”.

10 **EFFECTIVE DATE**

11 **SEC. 707.** The amendments made by sections 703, 704,
12 and 705 shall take effect on the effective date of title VI of
13 the Depository Institutions Deregulation and Monetary Con-
14 trol Act of 1980.

15 **LIMIT ON ADVANCES**

16 **SEC. 708.** Section 10(c) of the Federal Home Loan
17 Bank Act (12 U.S.C. 1430(c)) is amended by striking the
18 word “twelve” each time it appears and inserting in lieu
19 thereof the word “twenty”.

20 **TECHNICAL AMENDMENT TO RIGHT TO FINANCIAL**21 **PRIVACY ACT**

22 **SEC. 709.** Section 1114(b)(2) of the Right to Financial
23 Privacy Act of 1978 (12 U.S.C. 3414(b)(2)) is amended by
24 striking “of” following “institution”.

97TH CONGRESS
1ST SESSION

S. 1721

To combine the insurance funds of the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation and the National Credit Union Share Insurance Fund, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 7, 1981

Mr. GARN introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To combine the insurance funds of the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation and the National Credit Union Share Insurance Fund, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **TITLE I—FEDERAL DEPOSIT INSURANCE ACT**

4 **“SEC. 101. Section 1 of the Federal Deposit Insurance**
5 **Act (12 U.S.C. 1811) is amended to read as follows:**

6 **“SECTION 1. There is created a Federal Deposit Insur-**
7 **ance Corporation (hereinafter referred to as the ‘Corpora-**

1 tion') which shall insure the deposits of institutions eligible
2 for insurance as hereinafter provided, and which shall have
3 the powers hereinafter granted.'".

4 SEC. 102. Section 2 of the Federal Deposit Insurance
5 Act (12 U.S.C. 1812) is amended to read as follows:

6 "SEC. 2. (a) The management of the Corporation shall
7 be vested in a Board of Directors consisting of five members,
8 who shall be citizens of the United States to be appointed by
9 the President, by and with the advice and consent of the
10 Senate. One member shall be the Chairman of the Board of
11 Directors of the Corporation and not more than three of the
12 members of the Board of Directors shall be members of the
13 same political party. The members of the Board of Directors
14 shall hold office for such terms as are provided in paragraph
15 (b) of this section and shall be ineligible during the time they
16 are in office and for two years thereafter to hold any office,
17 position, or employment in any insured financial institution or
18 affiliate thereof except that this restriction shall not apply to
19 any member of has served the full term for which he or she
20 was appointed. No member of the Board of Directors shall be
21 an officer or director of an insured financial institution, any
22 affiliate of an insured financial institution, any Federal home
23 loan bank, or Federal Reserve bank or hold stock in any such
24 institution or affiliate; and before entering upon his or her
25 duties as a member of the Board of Directors he or she shall

1 certify under oath that he or she has complied with this re-
 2 quirement and such certification shall be filed with the execu-
 3 tive secretary of the Board of Directors.

4 "b) Upon the effective date of this statute, the two ex-
 5 isting appointive directors of the Corporation shall remain
 6 and shall serve for the remainder of their terms. The Presi-
 7 dent shall fill the remaining vacancies by appointing one of
 8 the members of the board for a term of three years, one for
 9 four years, and one for five years from January 1, 1983.
 10 Thereafter, the term of each member shall be six years from
 11 the date of the expiration of the term for which his or her
 12 predecessor was appointed. Whenever a vacancy shall occur
 13 among the members, the person appointed to fill the vacancy
 14 shall hold office for the unexpired portion of the term of the
 15 member whose place is being filled."

16 Sec. 103. Section 34a) of the Federal Deposit Insurance
 17 Act (12 U.S.C. 1813(a)) is amended to read: "The term
 18 'State bank' means any bank, banking association, trust com-
 19 pany, savings bank, or other banking institution which is en-
 20 gaged in the business of receiving deposits, other than trust
 21 funds as herein defined, and which is incorporated under the
 22 laws of any State, any territory or possession of the United
 23 States (including Guam, American Samoa, and the Virgin
 24 Islands), the Northern Mariana Islands, or Puerto Rico or
 25 which is operating under the Code of Law for the District of

1 Columbia (except a national bank), and includes any unincor-
 2 porated bank the deposits of which are insured on the effec-
 3 tive date of this amendment, and the word 'State' means any
 4 State of the United States, the District of Columbia, any ter-
 5 ritory or possession of the United States (including Guam,
 6 American Samoa, and the Virgin Islands), the Northern Mar-
 7 iana Islands, or Puerto Rico."

8 SEC. 104. Section 3(d) of the Federal Deposit Insurance
 9 Act (12 U.S.C. 1813(d)) is amended to read: "The term 'na-
 10 tional member bank' means any national bank located in any
 11 of the States of the United States, the District of Columbia,
 12 any territory or possession of the United States (including
 13 Guam, American Samoa, or the Virgin Islands), the North-
 14 ern Mariana Islands, or Puerto Rico which is a member of
 15 the Federal Reserve System."

16 SEC. 105. Section 3(e) of the Federal Deposit Insurance
 17 Act (12 U.S.C. 1813(e)) is amended to read:

18 "(1) The term 'national nonmember bank' means any
 19 national bank located in any territory or possession of the
 20 United States (including Guam, American Samoa, the Virgin
 21 Islands), the Northern Mariana Islands, or Puerto Rico
 22 which is not a member of the Federal Reserve System."

23 SEC. 106. Section 3(g) of the Federal Deposit Insurance
 24 Act (12 U.S.C. 1813(g)) is amended by striking out "*Pro-*
 25 *vided, further, That such bank to be considered a savings*

1 ing out "\$100,000" and inserting in lieu thereof
2 "\$250,000".

3 (b) The amendments made by subsection (a) are not ap-
4 plicable to—

5 (1) any claim arising out of the closing of a bank
6 prior to the effective date of this section;

7 (2) any claim arising out of a default, as defined
8 in section 401(d) of the National Housing Act (12
9 U.S.C. 1724(d)), where the appointment of a conserva-
10 tor, receiver, or other legal custodian as set forth in
11 that section became effective prior to the effective date
12 of this section; or

13 (3) any claim arising out of the closing of a credit
14 union for liquidation on account of bankruptcy or insol-
15 vency pursuant to section 207 of the Federal Credit
16 Union Act (12 U.S.C. 1787) prior to the effective date
17 of this section.

18 INTERNATIONAL BANKING FACILITIES

19 SEC. 702. Paragraph (5) of section 3(l) of the Federal
20 Deposit Insurance Act (12 U.S.C. 1813(l)) is amended to
21 read as follows:

22 "(5) such other obligations of a bank as the Board
23 of Directors, after consultation with the Comptroller of
24 the Currency and the Board of Governors of the Fed-
25 eral Reserve System, shall find and prescribe by regu-

1 lation to be deposit liabilities by general usage, except
 2 that the following shall not be a deposit for any of the
 3 purposes of this Act and shall not be included as part
 4 of total deposits or of an insured deposit:

5 “(A) any obligation of a bank which is pay-
 6 able only at an office of the bank located outside
 7 of the States of the United States, the District of
 8 Columbia, Puerto Rico, Guam, American Samoa,
 9 and the Virgin Islands; and

10 “(B) any international banking facility depos-
 11 it, including an international banking facility time
 12 deposit as that term is from time to time defined
 13 by the Board of Governors of the Federal Reserve
 14 System in its regulation D or any successor regu-
 15 lation thereto.”.

16 DEFINITION OF CREDITOR

17 SEC. 703. Section 103(f) of the Truth in Lending Act
 18 (15 U.S.C. 1602(f)) is amended to read as follows:

19 “(f) The term ‘creditor’ refers only to a person who both
 20 (1) regularly extends, whether in connection with loans, sales
 21 of property or services, or otherwise, consumer credit which
 22 is payable by agreement in more than four installments or for
 23 which the payment of a finance charge is or may be required,
 24 and (2) is the person to whom the debt arising from the con-
 25 sumer credit transaction is initially payable on the face of the

1 evidence of indebtedness or, if there is no such evidence of
2 indebtedness, by agreement. Notwithstanding the preceding
3 sentence, in the case of an open end credit plan involving a
4 credit card, the card issuer and any person who honors the
5 credit card and offers a discount which is a finance charge
6 are creditors. For the purpose of the requirements imposed
7 under chapter 4 and section 127(a)(5), 127(a)(6), 127(a)(7),
8 127(b)(1), 127(b)(2), 127(b)(3), 127(b)(8), and 127(b)(10) of
9 chapter 2 of this title, the term 'creditor' shall also include
10 card issuers whether or not the amount due is payable by
11 agreement in more than four installments or the payment of a
12 finance charge is or may be required, and the Board shall, by
13 regulation, apply these requirements to such card issuers, to
14 the extent appropriate, even though the requirements are by
15 their terms applicable only to creditors offering open end
16 credit plans."

17 RELATION TO STATE LAWS

18 SEC. 704. (a) Subsections (b), (c), and (d) of section 111
19 of the Truth in Lending Act are redesignated as subsections
20 (c), (d), and (e), respectively.

21 (b) Section 111 of the Truth in Lending Act (15 U.S.C.
22 1610) is amended by inserting under the caption the follow-
23 ing:

24 "(a)(1) Except as otherwise provided in this section, this
25 title supersedes any State law that is similar in purpose,

1 scope, requirement, or content to this title, to the extent of
2 the similarity. Similar laws include, but are not limited to,
3 laws relating to the disclosure or advertising of consumer
4 credit or lease terms, credit card and credit billing practices,
5 liability for consumer lease transactions, and the rescission of
6 consumer credit transactions.

7 “(2) Upon its own motion, or upon the request of any
8 creditor, lessor, State, or other interested party, the Board
9 shall determine whether a State law is similar to this title,
10 and thereby superseded, and shall publish notice of such de-
11 termination.

12 “(b) The provisions of this title shall not apply to any
13 extension of consumer credit or any consumer lease in any
14 State which makes a determination that such provisions shall
15 not apply with respect to extensions of consumer credit and
16 consumer leases subject to the laws of such State. Such de-
17 termination must—

18 “(1) explicitly and by its terms indicate the provi-
19 sions of this title that shall not apply in such State;

20 “(2) occur on or after the date of enactment of
21 this Act and prior to a date three years after such
22 date;

23 “(3) provide for an effective date at least one year
24 subsequent to such determination and permit creditors

1 failure to purchase shares from, obtain a loan from, or lend to
2 the Federal credit union.

3 “(c) Withdrawal or expulsion of a member pursuant to
4 either subsection (a) or (b) of this section shall not operate to
5 relieve him from liability to the Federal credit union.”.

6 TITLE VI—PROPERTY, CASUALTY, LIFE INSUR-
7 ANCE ACTIVITIES OF BANK HOLDING COM-
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9 SEC. 601. Section 4(c)(8) of the Bank Holding Company
10 Act of 1956 (12 U.S.C. 1843(c)(8)) is amended by striking
11 out the period at the end of the first sentence and inserting in
12 lieu thereof the following: “, but for purposes of this subsec-
13 tion it is not closely related to banking or managing or con-
14 trolling banks for a bank holding company to provide insur-
15 ance as a principal, agent, or broker except (A) where the
16 insurance is limited to assuring repayment of the outstanding
17 balance due on a specific extension of credit by a bank hold-
18 ing company or its subsidiary in the event of the death, dis-
19 ability, or involuntary unemployment of the debtor and, in
20 the case of involuntary unemployment, where the coverage is
21 offered in connection with a bank credit card and the card-
22 holder is solicited to purchase the coverage after the credit
23 card has been issued by the creditor; (B) in the case of a
24 finance company which is a subsidiary of a bank holding com-
25 pany, where the insurance is also limited to assuring repay-

1 ment of the outstanding balance on an extension of credit in
2 the event of loss or damage to any property used as collateral
3 on such extension of credit and, during the period beginning
4 on the date of the enactment of this subparagraph and ending
5 on December 31, 1980, such extension of credit is not more
6 than \$10,000 (\$25,000 in the case of an extension of credit
7 which is made to finance the purchase of a residential manu-
8 factured home and which is secured by such residential man-
9 ufactured home) and for any given year after 1980, such ex-
10 tension of credit is not more than an amount equal to
11 \$10,000 (\$25,000 in the case of an extension of credit which
12 is made to finance the purchase of a residential manufactured
13 home and which is secured by such residential manufactured
14 home) increased by the percentage increase in the Consumer
15 Price Index for Urban Wage Earners and Clerical Workers
16 published monthly by the Bureau of Labor Statistics for the
17 period beginning on January 1, 1980, and ending on Decem-
18 ber 31 of the year preceding the year in which such extension
19 of credit is made; (C) any insurance agency activity in a place
20 that (i) has a population not exceeding five thousand (as
21 shown by the last preceding decennial census), or (ii) the
22 bank holding company, after notice and opportunity for a
23 hearing, demonstrates has inadequate insurance agency facil-
24 ities; (D) any insurance agency activity which was engaged
25 in by the bank holding company or any of its subsidiaries on

1 June 12, 1980, or which the Board approved for such com-
2 pany or any of its subsidiaries on or before June 12, 1980, or
3 which was covered by an application accepted for processing
4 on or before April 29, 1980, and approved after June 12,
5 1980, including (i) sales of insurance at new locations of the
6 same bank holding company or the same subsidiary or subsid-
7 iaries with respect to which insurance was sold on June 12,
8 1980, or approved to be sold on or before June 12, 1980, or
9 covered by an application accepted for processing on or
10 before April 29, 1980, and approved after June 12, 1980, if
11 such new locations are confined to the State in which the
12 principal place of business of the bank holding company is
13 located, any State or States immediately adjacent to such
14 State, and any State or States in which insurance activities
15 were conducted by the bank holding company or any of its
16 subsidiaries on June 12, 1980, or were approved to be con-
17 ducted by the bank holding company or any of its subsidiaries
18 on or before June 12, 1980, or were covered by an applica-
19 tion accepted for processing on or before April 29, 1980, and
20 were approved after June 12, 1980, and (ii) sales of insur-
21 ance coverages which may become available after June 12,
22 1980, so long as those coverages insure against the same
23 types of risks as, or are otherwise functionally equivalent to,
24 coverages sold on June 12, 1980, or approved to be sold on
25 or before June 12, 1980; (E) any insurance activity where

1 the activity is limited solely to supervising on behalf of insur-
 2 ance underwriters the activities of retail insurance agents
 3 who sell (i) fidelity insurance and property and casualty in-
 4 surance on the real and personal property used in the oper-
 5 ations of the bank holding company or any of its subsidiaries,
 6 and (ii) group insurance that protects the employees of the
 7 bank holding company or any of its subsidiaries; or (F) any
 8 insurance agency activity engaged in by a bank holding com-
 9 pany, or any of its subsidiaries, which bank holding company
 10 has total assets of \$50,000,000 or less: *Provided, however,*
 11 That such bank holding company and its subsidiaries may not
 12 engage in the sale of life insurance or annuities except as
 13 provided in subparagraph (A), (B), or (C).''

14 TITLE VII—MISCELLANEOUS

15 DEPOSIT INSURANCE OF RETIREMENT ACCOUNTS

16 SEC. 701. (a)(1) The first sentence of section 405(d)(3)
 17 of the National Housing Act (12 U.S.C. 1728(d)(3)) is
 18 amended by striking out "\$100,000" and inserting in lieu
 19 thereof "\$250,000".

20 (2) The first sentence of section 11(a)(3) of the Federal
 21 Deposit Insurance Act (12 U.S.C. 1821(a)(3)) is amended by
 22 striking out "\$100,000" and inserting in lieu thereof
 23 "\$250,000".

24 (3) The first sentence of section 207(c)(3) of the Federal
 25 Credit Union Act (12 U.S.C. 1787(c)(3)) is amended by strik-

1 ing out "\$100,000" and inserting in lieu thereof
2 "\$250,000".

3 (b) The amendments made by subsection (a) are not ap-
4 plicable to—

5 (1) any claim arising out of the closing of a bank
6 prior to the effective date of this section;

7 (2) any claim arising out of a default, as defined
8 in section 401(d) of the National Housing Act (12
9 U.S.C. 1724(d)), where the appointment of a conserva-
10 tor, receiver, or other legal custodian as set forth in
11 that section became effective prior to the effective date
12 of this section; or

13 (3) any claim arising out of the closing of a credit
14 union for liquidation on account of bankruptcy or insol-
15 vency pursuant to section 207 of the Federal Credit
16 Union Act (12 U.S.C. 1787) prior to the effective date
17 of this section.

18 INTERNATIONAL BANKING FACILITIES

19 SEC. 702. Paragraph (5) of section 3(l) of the Federal
20 Deposit Insurance Act (12 U.S.C. 1813(l)) is amended to
21 read as follows:

22 "(5) such other obligations of a bank as the Board
23 of Directors, after consultation with the Comptroller of
24 the Currency and the Board of Governors of the Fed-
25 eral Reserve System, shall find and prescribe by regu-

1 lation to be deposit liabilities by general usage, except
 2 that the following shall not be a deposit for any of the
 3 purposes of this Act and shall not be included as part
 4 of total deposits or of an insured deposit:

5 “(A) any obligation of a bank which is pay-
 6 able only at an office of the bank located outside
 7 of the States of the United States, the District of
 8 Columbia, Puerto Rico, Guam, American Samoa,
 9 and the Virgin Islands; and

10 “(B) any international banking facility depos-
 11 it, including an international banking facility time
 12 deposit as that term is from time to time defined
 13 by the Board of Governors of the Federal Reserve
 14 System in its regulation D or any successor regu-
 15 lation thereto.”.

16 **DEFINITION OF CREDITOR**

17 **SEC. 703.** Section 103(f) of the Truth in Lending Act
 18 (15 U.S.C. 1602(f)) is amended to read as follows:

19 “(f) The term ‘creditor’ refers only to a person who both
 20 (1) regularly extends, whether in connection with loans, sales
 21 of property or services, or otherwise, consumer credit which
 22 is payable by agreement in more than four installments or for
 23 which the payment of a finance charge is or may be required,
 24 and (2) is the person to whom the debt arising from the con-
 25 sumer credit transaction is initially payable on the face of the

1 evidence of indebtedness or, if there is no such evidence of
2 indebtedness, by agreement. Notwithstanding the preceding
3 sentence, in the case of an open end credit plan involving a
4 credit card, the card issuer and any person who honors the
5 credit card and offers a discount which is a finance charge
6 are creditors. For the purpose of the requirements imposed
7 under chapter 4 and section 127(a)(5), 127(a)(6), 127(a)(7),
8 127(b)(1), 127(b)(2), 127(b)(3), 127(b)(8), and 127(b)(10) of
9 chapter 2 of this title, the term 'creditor' shall also include
10 card issuers whether or not the amount due is payable by
11 agreement in more than four installments or the payment of a
12 finance charge is or may be required, and the Board shall, by
13 regulation, apply these requirements to such card issuers, to
14 the extent appropriate, even though the requirements are by
15 their terms applicable only to creditors offering open end
16 credit plans."

17 **RELATION TO STATE LAWS**

18 **SEC. 704.** (a) Subsections (b), (c), and (d) of section 111
19 of the Truth in Lending Act are redesignated as subsections
20 (c), (d), and (e), respectively.

21 (b) Section 111 of the Truth in Lending Act (15 U.S.C.
22 1610) is amended by inserting under the caption the follow-
23 ing:

24 "(a)(1) Except as otherwise provided in this section, this
25 title supersedes any State law that is similar in purpose,

1 scope, requirement, or content to this title, to the extent of
2 the similarity. Similar laws include, but are not limited to,
3 laws relating to the disclosure or advertising of consumer
4 credit or lease terms, credit card and credit billing practices,
5 liability for consumer lease transactions, and the rescission of
6 consumer credit transactions.

7 “(2) Upon its own motion, or upon the request of any
8 creditor, lessor, State, or other interested party, the Board
9 shall determine whether a State law is similar to this title,
10 and thereby superseded, and shall publish notice of such de-
11 termination.

12 “(b) The provisions of this title shall not apply to any
13 extension of consumer credit or any consumer lease in any
14 State which makes a determination that such provisions shall
15 not apply with respect to extensions of consumer credit and
16 consumer leases subject to the laws of such State. Such de-
17 termination must—

18 “(1) explicitly and by its terms indicate the provi-
19 sions of this title that shall not apply in such State;

20 “(2) occur on or after the date of enactment of
21 this Act and prior to a date three years after such
22 date;

23 “(3) provide for an effective date at least one year
24 subsequent to such determination and permit creditors

1 and lessors to comply with such determination prior to
2 such effective date; and

3 “(4) be transmitted to the Board, which shall pub-
4 lish notice of the State’s determination, upon a finding
5 that the State law complies with the requirements of
6 this subsection.”.

7 (c) Sections 123, 171, 186(a), and 186(b) of such Act
8 are repealed.

9 (d) Section 167 of such Act is amended by adding at the
10 end thereof the following:

11 “(c) Notwithstanding any other provisions of this title,
12 any discount offered under subsection (b) shall not be consid-
13 ered a finance charge or other charge for credit under the
14 usury laws of any State or under the laws of any State relat-
15 ing to disclosure of information in connection with credit
16 transactions, or relating to the types, amounts or rates of
17 charges, or to any element or elements of charges permissible
18 under such laws in connection with the extension or use of
19 credit.”.

20 **CIVIL LIABILITY**

21 **SEC. 705. (a)** Section 130(a) of the Truth in Lending
22 Act (15 U.S.C. 1640(a)) is amended to read as follows:

23 “(a) Except as otherwise provided in this section, a
24 creditor who fails to comply with any requirement imposed
25 under this chapter, including any requirement under section

1 125, or chapter 4 or 5 of this title with respect to any person
2 is liable to such person in an amount equal to the sum of—

3 “(1) any actual damage sustained by such person
4 as a result of the failure;

5 “(2) in the case of an individual action, an amount
6 not greater than \$5,000, and in a class action, an
7 amount not greater than the lesser of \$500,000 or 1
8 per centum of the net worth of the creditor, if the
9 court finds that—

10 “(A) the creditor failed to comply with a re-
11 quirement of section 125; section 127(a); para-
12 graph (4), (5), (6), (7), (8), (9), or (10) of section
13 127(b); paragraph (2) (insofar as it requires a dis-
14 closure of the ‘amount financed’), (3), (4), (5), (6),
15 or (9) of section 128(a); section 182; or section
16 183; and

17 “(B) the creditor’s actions reflect substantial
18 noncompliance with the requirements of this title,
19 except that, in determining liability under this para-
20 graph, the court shall consider, among other relevant
21 factors, the amount of any actual damages awarded,
22 the frequency and persistence of failures of compliance
23 by the creditor, the resources of the creditor, the
24 number of persons adversely affected, and the extent to

1 which the creditor's failure of compliance was inten-
2 tional; and

3 “(3) in the case of any successful action to enforce
4 the foregoing liability or in any action in which a
5 person is determined to have a right of rescission under
6 section 125, the costs of the action, together with a
7 reasonable attorney's fee as determined by the court.”.

8 (b) Section 130(d) of such Act is amended to read as
9 follows:

10 “(d)(1) When there are multiple obligors in a consumer
11 credit transaction or consumer lease, there shall be no more
12 than one recovery of damages under subsection (a)(2) for a
13 violation of this title.

14 “(2) With respect to any failure to make disclosures re-
15 quired under this chapter or chapter 4 or 5 of this title, liabil-
16 ity may be imposed only upon the creditor required to make
17 disclosure, except as provided in section 131.”.

18 (c) The last sentence of section 625(c) of Public Law 96-
19 221 is amended by inserting “and by section 705 of the Fi-
20 nancial Institutions Restructuring and Services Act of 1981”
21 before the period.

1 **EXTENSION OF TRUTH IN LENDING SIMPLIFICATION**2 **EFFECTIVE DATE**

3 **SEC. 706.** Section 625(a) of the Depository Institutions
 4 Deregulation and Monetary Control Act of 1980 is amended
 5 to read as follows:

6 “**SEC. 625. (a)** Except as provided in section 608(b), the
 7 amendments made by this title shall take effect upon the ex-
 8 piration of two years and six months after the date of enact-
 9 ment of this title.”.

10 **EFFECTIVE DATE**

11 **SEC. 707.** The amendments made by sections 703, 704,
 12 and 705 shall take effect on the effective date of title VI of
 13 the Depository Institutions Deregulation and Monetary Con-
 14 trol Act of 1980.

15 **LIMIT ON ADVANCES**

16 **SEC. 708.** Section 10(c) of the Federal Home Loan
 17 Bank Act (12 U.S.C. 1430(c)) is amended by striking the
 18 word “twelve” each time it appears and inserting in lieu
 19 thereof the word “twenty”.

20 **TECHNICAL AMENDMENT TO RIGHT TO FINANCIAL**21 **PRIVACY ACT**

22 **SEC. 709.** Section 1114(b)(2) of the Right to Financial
 23 Privacy Act of 1978 (12 U.S.C. 3414(b)(2)) is amended by
 24 striking “of” following “institution”.

97TH CONGRESS
1ST SESSION

S. 1721

To combine the insurance funds of the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation and the National Credit Union Share Insurance Fund, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 7, 1981

Mr. GARN introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To combine the insurance funds of the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation and the National Credit Union Share Insurance Fund, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 TITLE I—FEDERAL DEPOSIT INSURANCE ACT

4 “SEC. 101. Section 1 of the Federal Deposit Insurance
5 Act (12 U.S.C. 1811) is amended to read as follows:

6 “SECTION 1. There is created a Federal Deposit Insur-
7 ance Corporation (hereinafter referred to as the ‘Corpora-

tion') which shall insure the deposits of institutions eligible
for insurance as hereinafter provided, and which shall have
the powers hereinafter granted."

SEC. 102. Section 2 of the Federal Deposit Insurance
Act (12 U.S.C. 1812) is amended to read as follows:

"SEC. 2. (a) The management of the Corporation shall
be vested in a Board of Directors consisting of five members,
who shall be citizens of the United States to be appointed by
the President, by and with the advice and consent of the
Senate. One member shall be the Chairman of the Board of
Directors of the Corporation and not more than three of the
members of the Board of Directors shall be members of the
same political party. The members of the Board of Directors
shall hold office for such terms as are provided in paragraph
(b) of this section and shall be ineligible during the time they
are in office and for two years thereafter to hold any office,
position, or employment in any insured financial institution or
affiliate thereof except that this restriction shall not apply to
any member of has served the full term for which he or she
was appointed. No member of the Board of Directors shall be
an officer or director of an insured financial institution, any
affiliate of an insured financial institution, any Federal home
loan bank, or Federal Reserve bank or hold stock in any such
institution or affiliate; and before entering upon his or her
duties as a member of the Board of Directors he or she shall

1 certify under oath that he or she has complied with this re-
2 quirement and such certification shall be filed with the execu-
3 tive secretary of the Board of Directors.

4 “(b) Upon the effective date of this statute, the two ex-
5 isting appointive directors of the Corporation shall remain
6 and shall serve for the remainder of their terms. The Presi-
7 dent shall fill the remaining vacancies by appointing one of
8 the members of the board for a term of three years, one for
9 four years, and one for five years from January 1, 1983.
10 Thereafter, the term of each member shall be six years from
11 the date of the expiration of the term for which his or her
12 predecessor was appointed. Whenever a vacancy shall occur
13 among the members, the person appointed to fill the vacancy
14 shall hold office for the unexpired portion of the term of the
15 member whose place is being filled.”.

16 SEC. 103. Section 3(a) of the Federal Deposit Insurance
17 Act (12 U.S.C. 1813(a)) is amended to read: “The term
18 ‘State bank’ means any bank, banking association, trust com-
19 pany, savings bank, or other banking institution which is en-
20 gaged in the business of receiving deposits, other than trust
21 funds as herein defined, and which is incorporated under the
22 laws of any State, any territory or possession of the United
23 States (including Guam, American Samoa, and the Virgin
24 Islands), the Northern Mariana Islands, or Puerto Rico or
25 which is operating under the Code of Law for the District of

1 Columbia (except a national bank), and includes any unincor-
2 porated bank the deposits of which are insured on the effec-
3 tive date of this amendment, and the word 'State' means any
4 State of the United States, the District of Columbia, any ter-
5 ritory or possession of the United States (including Guam,
6 American Samoa, and the Virgin Islands), the Northern Mar-
7 iana Islands, or Puerto Rico."

8 SEC. 104. Section 3(d) of the Federal Deposit Insurance
9 Act (12 U.S.C. 1813(d)) is amended to read: "The term 'na-
10 tional member bank' means any national bank located in any
11 of the States of the United States, the District of Columbia,
12 any territory or possession of the United States (including
13 Guam, American Samoa, or the Virgin Islands), the North-
14 ern Mariana Islands, or Puerto Rico which is a member of
15 the Federal Reserve System."

16 SEC. 105. Section 3(e) of the Federal Deposit Insurance
17 Act (12 U.S.C. 1813(e)) is amended to read:

18 "(1) The term 'national nonmember bank' means any
19 national bank located in any territory or possession of the
20 United States (including Guam, American Samoa, the Virgin
21 Islands), the Northern Mariana Islands, or Puerto Rico
22 which is not a member of the Federal Reserve System."

23 SEC. 106. Section 3(g) of the Federal Deposit Insurance
24 Act (12 U.S.C. 1813(g)) is amended by striking out "*Pro-*
25 *vided, further,* That such bank to be considered a savings

1 bank must elect to become subject to regulations of the Cor-
2 poration with respect to the redeposit of maturing deposits
3 and prohibiting withdrawal of deposits by checking except in
4 cases where such withdrawal was permitted by law on
5 August 23, 1935, from specifically designated deposit ac-
6 counts totaling not more than 15 per centum of the bank's
7 total deposits".

8 SEC. 107. Section (3)(h) of the Federal Deposit Insur-
9 ance Act (12 U.S.C. 1813(h)) is amended—

10 (1) by striking out "bank" the first and fourth
11 time it appears and inserting "financial institution" in
12 lieu thereof;

13 (2) by inserting ", credit union, or savings and
14 loan association" after "insured branch" and after
15 "bank" the fifth time it appears.

16 SEC. 108. Section 3(i) of the Federal Deposit Insurance
17 Act (12 U.S.C. 1813(i)) is amended by striking out "bank"
18 the second time it appears and inserting "financial institu-
19 tion" in lieu thereof.

20 SEC. 109. Section 3(j) of the Federal Deposit Insurance
21 Act (12 U.S.C. 1813(j)) is amended by striking out "bank or
22 a branch of foreign bank" the first time it appears and insert-
23 ing "financial institution" in lieu thereof.

24 SEC. 110. Section 3(l) of the Federal Deposit Insurance
25 Act (12 U.S.C. 1813(l)) is amended—

1 (1) by designating the introductory phrase "The
2 term 'deposit' means" as paragraph "(1)" and chang-
3 ing it to read:

4 "(1) The term 'deposit' for an insured bank means—";

5 (2) by redesignating paragraphs (1), (2), (3), (4),
6 and (5) as subparagraphs (a), (b), (c), (d), and (e), re-
7 spectively, of the new paragraph (1);

8 (3) by revising the proviso in the new subpara-
9 graph (e) of paragraph (1) to read: "*Provided further,*
10 That any obligation of a bank which is payable only at
11 an office of the bank located outside of the States of
12 the United States, the District of Columbia, the terri-
13 tories and possessions of the United States (including
14 Guam, American Samoa, and the Virgin Islands), the
15 Northern Mariana Islands, or Puerto Rico, shall not be
16 a deposit for any of the purposes of this Act or be in-
17 cluded as part of total deposits or of an insured depos-
18 it."; and

19 (4) by adding new paragraphs (2) and (3) to read:

20 "(2) The term 'deposit' for a credit union means, the
21 unpaid balance of money or its equivalent received or held by
22 a credit union in the usual course of business for which it has
23 given, or is obligated to give, credit to a share, share certifi-
24 cate, or share draft account of a member of the credit union,
25 of a nonmember in the case of a credit union serving pre-

1 dominately low-income members (as defined by the Corpora-
2 tion's Board of Directors after consultation with the National
3 Credit Union Administration Board), or of nonmember credit
4 unions and nonmember units of Federal, State, or local gov-
5 ernments and political subdivisions thereof. The share, share
6 certificate or share draft accounts shall be the type approved
7 by the Corporation's Board of Directors after consultation
8 with the National Credit Union Administration Board and
9 may include the equivalent of such accounts under State law.

10 “(3) The term ‘deposit’ for a savings and loan associ-
11 ation means a savings, tax and loan, or checking deposit (as
12 defined by the Corporation's Board of Directors after consul-
13 tation with the Federal Home Loan Bank Board) held by the
14 savings and loan association.”.

15 SEC. 111. Section 3(m) of the Federal Deposit Insur-
16 ance Act (12 U.S.C. 1813(m)) is amended—

17 (1) by striking out “bank” each place it appears
18 in the first and second sentences of paragraph (1) and
19 inserting “financial institution” in lieu thereof;

20 (2) by striking out the third sentence of paragraph
21 (1) and inserting: “Each officer, employee, or agent of
22 the United States, of any State of the United States, of
23 the District of Columbia, of any territory or possession
24 of the United States (including Guam, American
25 Samoa, and the Virgin Islands), of the Northern Mari-

1 ana Islands, of Puerto Rico, of the Panama Canal
2 Zone, of any county, of any municipality, of any politi-
3 cal subdivision, or of any Indian Tribe therein, herein
4 called 'public unit', having official custody of public
5 funds and lawfully depositing the same in an insured
6 financial institution shall, for the purpose of determin-
7 ing the amount of the insured deposits, be deemed a
8 depositor in such custodial capacity separate and dis-
9 tinct from any other officer, employee, or agent of the
10 same or any public unit having custody of public funds
11 and lawfully depositing the same in the same insured
12 bank in custodial capacity."; and

13 (3) by striking out "ther" in the introductory
14 phrase of paragraph (2) and inserting "term" in lieu
15 thereof.

16 SEC. 112. Section 3(n) of the Federal Deposit Insurance
17 Act (12 U.S.C. 1813(n)) is amended by striking out "bank"
18 the second, third, and fifth times it appears and inserting "fi-
19 nancial institution" in lieu thereof.

20 SEC. 113. Section 3(o) of the Federal Deposit Insurance
21 Act (12 U.S.C. 1813(o)) is amended to read:

22 "(o) The term 'domestic branch' includes any branch
23 office, branch agency, additional office, or any branch place
24 of business of a financial institution located in any State of
25 the United States, any territory or possession of the United

1 States (including Guam, American Samoa and the Virgin Is-
2 lands), the Northern Mariana Islands, or Puerto Rico (or in
3 the Panama Canal Zone in the case of a credit union) at
4 which deposits are received or checks are paid or money lent;
5 and the term 'foreign branch' means any office or place of
6 business located outside the United States, its territories or
7 possessions, the Northern Mariana Islands, Puerto Rico, or
8 the Panama Canal Zone (in the case of a credit union) at
9 which a financial institution's operations are conducted, in-
10 cluding the operations of a credit union authorized by the
11 Department of Defense to be located on American military
12 installations in foreign countries."

13 SEC. 114. Section 3(p) of the Federal Deposit Insurance
14 Act (12 U.S.C. 1813(p)) is amended by striking out "bank"
15 and inserting "financial institution" in lieu thereof:

16 SEC. 115. Section 3(q) is amended—

17 (1) by striking out "banking" in the introductory
18 phrase and inserting "financial institution" in lieu
19 thereof;

20 (2) by striking out "and" at the end of subpara-
21 graph (2);

22 (3) by striking out "nonmember insured bank
23 (except a District bank)" in subparagraph (3) and in-
24 serting "financial institution" in lieu thereof;

1 (4) by striking out "banking" in the second sen-
2 tence of subparagraph (3) and inserting "financial insti-
3 tution" in lieu thereof;

4 (5) by striking out "bank" the first time it appears
5 in the third sentence of subparagraph (3) and inserting
6 "financial institution" in lieu thereof;

7 (6) by adding new subparagraphs (4) and (5) to
8 read: "(4) the Federal Home Loan Bank Board for
9 Federal savings and loans associations; and
10 (7) the National Credit Union Administration for
11 Federal credit unions.

12 SEC. 116. Section 3 of the Federal Deposit Insurance
13 Act (12 U.S.C. 1813) is further amended—

14 (1) by adding a new paragraph (t) which reads:

15 "(t) The term 'Federal savings and loan association' or
16 'Federal association' means a savings and loan association
17 chartered by the Federal Home Loan Bank Board under sec-
18 tion 5 of the Home Owners' Loan Act of 1933 and, except as
19 the Federal Home Loan Bank Board may otherwise provide,
20 any building and loan building, or homestead association, or-
21 ganized or incorporated under the laws of the District of Co-
22 lumbia.";

23 (2) by adding a new paragraph (u) which reads:

24 "(u) The term 'State savings and loan association' or
25 'State association' means any building and loan, savings and

1 loan, or homestead association, or cooperative bank orga-
2 nized under the laws of any State which may, under those
3 laws, merge or consolidate with a Federal saving and loan
4 association.”;

5 (3) by adding a new paragraph (v) which reads:

6 “(v) The term ‘savings and loan association’ or ‘associ-
7 ation’ means any Federal or State savings and loan associ-
8 ation.”;

9 (4) by adding a new paragraph (w) which reads:

10 “(w) The term ‘Federal credit union’ means a coopera-
11 tive association organized under the Federal Credit Union
12 Act for the purpose of promoting thrift among its members
13 and creating a source of credit for provident or productive
14 purposes.”;

15 (5) by adding a new paragraph (x) which reads:

16 “(x) The term ‘State credit union’ means a credit union
17 organized and operated according to the laws of any State,
18 the District of Columbia, the several territories and posses-
19 sions of the United States, the Panama Canal Zone, or the
20 Commonwealth of Puerto Rico which laws provide for the
21 organization of credit unions similar in principle and objec-
22 tives of Federal credit unions.”;

23 (6) by adding a new paragraph (y) which reads:

24 “(y) The term ‘credit union’ means any Federal or State
25 credit union.”; and

1 (7) by adding a new paragraph (z) which reads:

2 “(z) The term ‘territory’ as used in this Act includes
3 trust territories.”.

4 SEC. 117. Section 4 of the Federal Deposit Insurance
5 Act (12 U.S.C. 1814) is amended to read as follows:

6 “SEC. 4 (a) Every bank which was insured by the Cor-
7 poration and every association which was insured by the
8 Federal Savings and Loan Insurance Corporation on the ef-
9 fective date of this Act shall continue to be insured, without
10 application or approval, and shall be subject to the provisions
11 of this Act as an insured financial institution. Every credit
12 union which is insured by the National Credit Union Share
13 Insurance Fund on January 1, 1985, shall become an insured
14 financial institution, without application or approval, and
15 shall be subject to the provisions of this Act.

16 “(b)(1) Every national member bank which is authorized
17 to commence or resume a banking business and which is en-
18 gaged in the business of receiving deposits, other than trust
19 funds as herein defined, shall be an insured financial institu-
20 tion from the time it is authorized to commence or resume a
21 banking business. Any national nonmember bank which is
22 engaged in the business of receiving deposits, other than trust
23 funds as herein defined, may upon application to the Comp-
24 troller of the Currency be an insured financial institution.
25 The Comptroller of the Currency shall certify to the Corpora-

1 tion in the case of a national member or nonmember bank
2 that the bank is engaged in the business of receiving deposits,
3 other than trust funds as herein defined, and that considera-
4 tion has been given to the factors enumerated in section 6.

5 “(2) Every State bank which becomes a member of the
6 Federal Reserve System and which is engaged in the busi-
7 ness of receiving deposits, other than trust funds as herein
8 defined, shall be an insured financial institution from the time
9 it becomes a member of the Federal Reserve System. The
10 Board of Governors of the Federal Reserve System shall cer-
11 tify to the Corporation that the bank is a member of the
12 Federal Reserve System, that the bank is engaged in the
13 business of receiving deposits, other than trust funds, and
14 that consideration has been given to the factors enumerated
15 in section 6.

16 “(3) An insured bank which is admitted to the Federal
17 Reserve System or an insured State bank which is converted
18 into a national member bank shall continue as an insured
19 financial institution and, notwithstanding paragraphs (b) (1)
20 or (2), no certificate is required. A State bank which results
21 from the conversion of an insured national bank shall contin-
22 ue as an insured financial institution. A State bank, resulting
23 from the merger or consolidation of insured banks, or from
24 the merger or consolidation of a noninsured bank or institu-
25 tion with a State bank shall continue as an insured bank.

1 “(c) Every Federal association which is authorized to
2 commence or resume business, and which is engaged in the
3 business of receiving deposits other than trust funds as herein
4 defined shall be an insured financial institution from the time
5 it is authorized to commence or resume business. The Fed-
6 eral Home Loan Bank Board shall certify to the Corporation
7 for each Federal association chartered beginning January 1,
8 1983, that the association is authorized to receive deposits
9 other than trust funds and that consideration has been given
10 to the factors enumerated in section 6.

11 “(d) Effective January 1, 1985, every Federal credit
12 union which is authorized to commence or resume business,
13 and which is engaged in the business of receiving deposits
14 other than trust funds as herein defined shall be an insured
15 financial institution from the time it is authorized to com-
16 mence or resume business. The National Credit Union Ad-
17 ministration Board shall certify to the Corporation for each
18 Federal credit union chartered beginning January 1, 1985,
19 that the credit union is authorized to receive deposits other
20 than trust funds and that consideration has been given to the
21 factors enumerated in section 6.”.

22 SEC. 118. Section 5(a) of the Federal Deposit Insurance
23 Act (12 U.S.C. 1815(a)) is amended to read as follows:

24 “(a) Subject to the provisions of this Act, any State fi-
25 nancial institution, upon application to and examination by

1 the Corporation and approval by the Board of Directors, may
2 become an insured financial institution. Before approving the
3 application of any such State financial institution, the Board
4 of Directors shall give consideration to the factors enumer-
5 ated in section 6 and shall determine, upon the basis of a
6 thorough examination of such institution that its assets in
7 excess of its capital requirements are adequate to enable it to
8 meet all of its liabilities to depositors and other creditors as
9 shown by the books of the institution.”.

10 SEC. 119. Section 6 of the Federal Deposit Insurance
11 Act (12 U.S.C. 1816) is amended by striking out “bank”
12 each place it appears therein and inserting “financial institu-
13 tion” in lieu thereof.

14 SEC. 120. (a) The first paragraph of section 7(a) of the
15 Federal Deposit Insurance Act (12 U.S.C. 1817(a)) is
16 amended—

17 (1) by striking out “State nonmember bank
18 (except a District bank) and each foreign bank having
19 an insured branch” and inserting in lieu thereof “finan-
20 cial institution”; and

21 (2) by striking out “bank” in the last sentence
22 and inserting in lieu thereof “financial institution”.

23 (b) The second paragraph of section 7(a) of the Federal
24 Deposit Insurance Act (12 U.S.C. 1817(a)) is amended to
25 read as follows:

1 “(2) The Corporation shall have access to reports of ex-
2 amination made by, and any report made to, the Comptroller
3 of the Currency, any Federal Reserve Bank, any Federal
4 home loan bank, or to the National Credit Union Administra-
5 tion Board. The Corporation may accept any report made by
6 or to the Comptroller of the Currency, any Federal Reserve
7 bank, any Federal home loan bank, the National Credit
8 Union Administration Board, or to any commission, board, or
9 authority having supervision of a State financial institution,
10 and may furnish to the Comptroller of the Currency, any
11 Federal Reserve bank, any Federal home loan bank, the Na-
12 tional Credit Union Administration Board or to any such
13 commission, board, or authority, reports of examination made
14 on behalf of, and reports of condition made to, the Corpora-
15 tion.”.

16 (c) The third paragraph of section 7(a) of the Federal
17 Deposit Insurance Act (12 U.S.C. 1817(a)) is amended—

18 (1) by striking out the first sentence and inserting
19 in lieu thereof: “Each insured financial institution shall
20 make to the Corporation four reports of condition an-
21 nually upon dates which shall be selected by the Board
22 of Directors.”;

23 (2) by striking out “banks” each place it appears
24 following the first sentence and inserting in lieu thereof
25 “financial institutions”;

1 (3) by striking out "bank" each place it appears
2 following the first sentence and inserting in lieu thereof
3 "financial institutions";

4 (4) by striking out "by the respective agencies" at
5 the end of the fourth sentence;

6 (5) by striking out "said" after "Each" in the
7 fifth sentence;

8 (6) by striking out "said report of condition" in
9 the sixth sentence and inserting in lieu thereof "reports
10 of condition";

11 (7) by striking out the seventh sentence;

12 (8) by striking out "any of the foregoing agen-
13 cies" in the eighth sentence and inserting in lieu there-
14 of "the Corporation"; and

15 (9) by adding at the end thereof, the following
16 sentence: "The Comptroller of the Currency, any Fed-
17 eral Reserve Bank, any Federal Home Loan Bank,
18 and the National Credit Union Administration Board
19 may require additional reports of condition or other re-
20 ports from financial institutions subject to their respec-
21 tive jurisdictions. Such reports shall be in such form
22 and contain such information as required by the appro-
23 priate agency."

24 (d) The fourth paragraph of section 7(a) of the Federal
25 Deposit Insurance Act (12 U.S.C. 1817(a)) is amended—

1 (1) by striking out "any territory of the United
2 States, Puerto Rico, Guam, American Samoa, or the
3 Virgin Islands" in the first sentence and inserting "any
4 territory or possession of the United States (including
5 Guam, American Samoa, and the Virgin Islands), the
6 Northern Mariana Islands, or Puerto Rico or in the
7 Panama Canal Zone or on military installations in for-
8 eign countries in the case of credit unions," in lieu
9 thereof;

10 (2) by striking out "bank" each place it appears
11 therein and inserting "financial institution" in lieu
12 thereof;

13 (3) by striking out "banks" each place it appears
14 therein and inserting "financial institutions" in lieu
15 thereof.

16 (e) The sixth paragraph of section 7(a) of the Federal
17 Deposit Insurance Act (12 U.S.C. 1817(c)) is amended—

18 (1) by inserting a comma after "Currency";

19 (2) by striking "and" after "Currency"; and

20 (3) by inserting after "Federal Reserve System"
21 the following: ", the Federal Home Loan Bank Board
22 and the National Credit Union Administration Board,".

23 (f) The seventh paragraph of section 7(a) of the Federal
24 Deposit Insurance Act (12 U.S.C. 1817(a)) is amended—

1 (1) by striking out "or the Comptroller of the
2 Currency, as the case may be,";

3 (2) by striking out "banks" each place it appears
4 and inserting in lieu thereof "financial institutions";
5 and

6 (3) by striking out "their" before "judgment" and
7 inserting in lieu thereof "its".

8 (g) Section 7(b) of the Federal Deposit Insurance Act
9 (12 U.S.C. 1817(b)) is amended—

10 (1) by striking out "banks" each place it appears
11 therein and inserting "financial institutions" in lieu
12 thereof;

13 (2) by striking out "bank" each place it appears
14 therein, except the first time it appears in subpara-
15 graph (B) of the fourth paragraph, and inserting "fi-
16 nancial institution" in lieu thereof; and

17 (3) by striking out "in the United States, the Dis-
18 trict of Columbia, Puerto Rico, Guam, American
19 Samoa, or the Virgin Islands," in subparagraph (5)(B)
20 and inserting "any State of the United States, the Dis-
21 trict of Columbia, any territory or possession of the
22 United States (including Guam, American Samoa, and
23 the Virgin Islands), or ther Northern Mariana Islands
24 or on military installations in foreign countries in the
25 case of credit unions," in lieu thereof;

1 (h) Section 7(c) of the Federal Deposit Insurance Act
2 (12 U.S.C. 1817(c)) is amended—

3 (1) by striking out “bank” each place it appears
4 and inserting “financial institution” in lieu thereof; and

5 (2) by striking out “banks” each place it appears
6 and inserting “financial institutions” in lieu thereof.

7 (i) Section 7(d) of the Federal Deposit Insurance Act
8 (12 U.S.C. 1817(d)) is amended—

9 (1) by striking from the first sentence of the first
10 paragraph “As of December 31, 1980, and”;

11 (2) by inserting a comma in the first sentence of
12 the first paragraph after the word “year” the first time
13 it appears;

14 (3) by striking from the first sentence of the first
15 paragraph “thereafter”;

16 (4) by striking from the third sentence of the first
17 paragraph “and” as it appears before “(3)”;

18 (5) by striking the period at the end of the third
19 sentence of the first paragraph and adding: “; and (4)
20 any lending costs for the calendar year, which shall be
21 the difference between the rate of interest earned, if
22 any, from each loan made by the Corporation pursuant
23 to section 13 of this Act and the Corporation’s average
24 investment portfolio yield for the calendar year.”;

1 (6) by striking out "bank" each place it appears
2 therein and inserting "financial institution" in lieu
3 thereof; and

4 (7) by striking out "banks" each place it appears
5 therein and inserting "financial institutions" in lieu
6 thereof.

7 (j) Section 7(e) of the Federal Deposit Insurance Act (12
8 U.S.C. 1817(e)) is amended by striking out "bank" each
9 place it appears and inserting "financial institution" in lieu
10 thereof.

11 (k) Section 7(f) of the Federal Deposit Insurance Act
12 (12 U.S.C. 1817(f)) is amended by striking out "bank" each
13 place it appears and inserting "financial institution" in lieu
14 thereof.

15 (l) Section 7(g) of the Federal Deposit Insurance Act
16 (12 U.S.C. 1817(g)) is amended—

17 (1) by striking out "bank" each place it appears
18 and inserting "financial institution" in lieu thereof;

19 (2) by striking out the colon at the end of the
20 second sentence and inserting a period in lieu thereof;
21 and

22 (3) by striking out the last portion of the para-
23 graph, beginning with "*Provided, however*".

24 (m) Section 7(h) of the Federal Deposit Insurance Act
25 (12 U.S.C. 1817(h)) is hereby repealed.

1 (n) Section 7(i) of the Federal Deposit Insurance Act
2 (12 U.S.C. 1817(i)) is amended—

3 (1) by striking out “(i)” and inserting “(h)” in lieu
4 thereof; and

5 (2) by striking out “bank” each place it appears
6 and inserting “financial institution” in lieu thereof.

7 (o) Section 7(j) of the Federal Deposit Insurance Act
8 (12 U.S.C. 1817(j)) is amended—

9 (1) by striking out “(j)” each place it appears and
10 inserting “(i)” in lieu thereof;

11 (2) by striking out “bank” and “banking” each
12 place they appear in the first three sentences of the
13 first paragraph and inserting “financial institution” in
14 lieu thereof;

15 (3) by striking out “bank” in the fourth sentence
16 of the first paragraph the first and third place it ap-
17 pears and inserting “financial institution” in lieu there-
18 of;

19 (4) by striking out “banking” in the fourth sen-
20 tence of the first paragraph and inserting “financial in-
21 stitution” in lieu thereof;

22 (5) by striking out the period at the end of the
23 fourth sentence of the first paragraph and inserting a
24 semicolon in lieu thereof and by adding: “the term ‘in-
25 sured financial institution’ shall also include any ‘sav-

1 ings and loan holding company,' as that term is defined
2 in section 408 of the National Housing Act (12 U.S.C.
3 1730a), which has control of any insured financial in-
4 stitution and the appropriate financial institution
5 agency in the case of savings and loan holding compa-
6 nies shall be the Federal Home Loan Bank Board.”;

7 (6) by striking out “bank” and “banking” each
8 place they appear in the second paragraph and, except
9 in the phrase “State bank supervisory agency,” insert-
10 ing “financial institution” in lieu thereof;

11 (7) by striking out “bank” and “banking” each
12 place they appear in paragraphs (3) through (13), and
13 in paragraph (15), and inserting “financial institution”
14 in lieu thereof;

15 (8) by striking out all of paragraph (14), which is
16 hereby repealed;

17 (9) by striking out “(15)” and inserting “(14)” in
18 lieu thereof;

19 (10) by striking out “(16)” and inserting “(15)” in
20 lieu thereof; and

21 (11) by inserting a comma after “(12 U.S.C.
22 1842)” in paragraph (15) as redesignated and inserting
23 the following: “or section 408 of the National Housing
24 Act (12 U.S.C. 1730a),”.

1 (p) Section 7(k) of the Federal Deposit Insurance Act
2' (12 U.S.C. 1817(k)) is amended by striking out the entire
3 provision, which is hereby repealed.

4 SEC.121. (a) Section 8(a) of the Federal Deposit Insur-
5 ance Act (12 U.S.C. 1818(a)) is amended—

6 (1) by striking out “bank” the first and last places
7 it appears in the first sentence and inserting “financial
8 institution” in lieu thereof;

9 (2) by inserting after “national member bank” the
10 first place it appears in the first sentence the following:
11 “, a Federal association, a Federal credit union,”;

12 (3) by striking out “bank” the first, second, third,
13 fourth, seventh, eighth, and tenth places it appears in
14 the second sentence and inserting “financial institu-
15 tion” in lieu thereof;

16 (4) by inserting after “State member bank” in the
17 second sentence the following: “, to the Federal Home
18 Loan Bank Board in the case of a Federal association,
19 and to the National Credit Union Administration Board
20 in the case of a Federal credit union,”;

21 (5) by striking out “bank” the second, fourth,
22 fifth, and sixth places it appears in the third sentence
23 and inserting “financial institution” in lieu thereof;

24 (6) by inserting after “State member bank” in the
25 third sentence the following: “, or the Federal Home

1 Loan Bank Board in the case of a Federal association,
2 or the National Credit Union Administration Board in
3 the case of a Federal credit union,"; and

4 (7) by striking out "bank" each place it appears
5 in sentences four through ten and inserting "financial
6 institution" in lieu thereof.

7 (b) Section 8(b) of the Federal Deposit Insurance Act
8 (12 U.S.C. 1818(b)) is amended—

9 (1) by striking out "banking" and "bank" each
10 place they appear in the first and second paragraphs
11 and inserting "financial institution" in lieu thereof;

12 (2) by striking out "bank" as it appears in the
13 first sentence of paragraph three in "(other than a
14 bank)" and inserting "financial institution" in lieu
15 thereof;

16 (3) by striking out "banking" in the second sen-
17 tence of paragraph (3) and inserting "financial institu-
18 tion" in lieu thereof;

19 (4) by striking out "bank" in the second sentence
20 of paragraph 3 the second and third places it appears
21 and inserting "financial institution" in lieu thereof;

22 (5) by striking out "bank" in paragraph (4) the
23 second and fifth places it appears and inserting "finan-
24 cial institution" in lieu thereof; and

25 (6) by adding the following paragraph:

1 “(5) This subsection and subsections (c) through (f) and
2 (h) through (n) of this section shall apply to any savings and
3 loan holding company, and to any subsidiary (other than an
4 insured financial institution) of a savings and loan holding
5 company, as those terms are defined in section 408 of the
6 National Housing Act (12 U.S.C. 1730a).”.

7 (c) Section 8(c) of the Federal Deposit Insurance Act
8 (12 U.S.C. 1818(c)) is amended by striking out “banking”
9 and “bank” each place they appear and inserting “financial
10 institution” in lieu thereof.

11 (d) Section 8(d) of the Federal Deposit Insurance Act
12 (12 U.S.C. 1818(d)) is amended by striking out “banking”
13 and “bank” each place they appear and inserting “financial
14 institution” in lieu thereof.

15 (e) Section 8(e) of the Federal Deposit Insurance Act
16 (12 U.S.C. 1818(e)) is amended—

17 (1) by striking out “banking” and “bank” each
18 place they appear in paragraphs (1), (2), (3), and (5)
19 and inserting “financial institution” in lieu thereof; and

20 (2) by striking out “bank” each place it appears
21 in the first and fourth sentences of paragraph (4) and
22 inserting “financial institution” in lieu thereof.

23 (f) Section 8(f) of the Federal Deposit Insurance Act (12
24 U.S.C. 1818(f)) is amended by striking out “bank” each

1 place it appears and inserting "financial institution" in lieu
2 thereof.

3 (g) Section 8(g) of the Federal Deposit Insurance Act
4 (12 U.S.C. 1818(g)) is amended—

5 (1) by striking out "bank" and "banking" each
6 place they appear in paragraph (1) and inserting
7 "financial institution" in lieu thereof;

8 (2) by inserting in the first sentence of paragraph
9 (2) after "national bank" the following: ", a Federal
10 association or a Federal credit union,";

11 (3) by inserting in the second sentence of para-
12 graph (2) after "national bank" the following: ", a
13 Federal association or a Federal credit union,";

14 (4) by inserting in the second sentence of para-
15 graph (2) after "Currency" the following: ", the
16 Federal Home Loan Bank Board, or the National
17 Credit Union Administration Board, as the case may
18 be,";

19 (5) by striking out "bank" the last place it ap-
20 pears in the second sentence of paragraph (2) and in-
21 serting "financial institution" in lieu thereof; and

22 (6) by striking out "bank" and "banking" each
23 place they appear in paragraph (3) and inserting "fi-
24 nancial institution" in lieu thereof.

1 (h) Section 8(h) through section 8(n) of the Federal De-
2 posit Insurance Act (12 U.S.C. 1818(h)–(n)) is amended—

3 (1) by striking out “bank” and “banking” each
4 place they appear and inserting “financial institution”
5 in lieu thereof; and

6 (2) by striking out “banks” each place it appears
7 and inserting “financial institutions” in lieu thereof.

8 (i) Section 8(o) of the Federal Deposit Insurance Act
9 (12 U.S.C. 1818(o)) is amended—

10 (1) by inserting in the first sentence after “nation-
11 al member bank” the following: “, a Federal associ-
12 ation or a Federal credit union,”;

13 (2) by inserting in the first sentence after “Cur-
14 rency” the following: “, the Federal Home Loan Bank
15 Board of the National Credit Union Administration
16 Board, as the case may be,”;

17 (3) by striking out “bank” the last place it ap-
18 pears in the first sentence and inserting “financial in-
19 stitution” in lieu thereof; and

20 (4) by striking out “board of directors” each place
21 it appears in the second sentence and inserting “Board
22 of Directors” in lieu thereof.

23 (j) Section 8(p) of the Federal Deposit Insurance Act
24 (12 U.S.C. 1818(p)) is amended—

1 (1) by striking out "banking" the first place it ap-
2 pears in the first sentence and inserting "financial" in
3 lieu thereof;

4 (2) by striking out "banking" the second place it
5 appears in the first sentence;

6 (3) by striking out "banking" in the second sen-
7 tence and inserting "financial" in lieu thereof; and

8 (4) by striking out "banking" each place it ap-
9 pears in the third and fourth sentences.

10 (k) Section 8(q) of the Federal Deposit Insurance Act
11 (12 U.S.C. 1818(q)) is amended—

12 (1) by striking out "bank" each place it appears
13 and inserting "financial institution" in lieu thereof; and

14 (2) by striking out "banks" each place it appears
15 and inserting "financial institutions" in lieu thereof.

16 SEC. 122. Section 9 of the Federal Deposit Insurance
17 Act (12 U.S.C. 1819) is amended—

18 (1) by changing the introductory phrase to read:
19 "The Corporation is established as a body corporate
20 and it shall have the following powers";

21 (2) by striking out "bank" each place it appears
22 and inserting "financial institution" in lieu thereof; and

23 (3) by striking out "banks" each place it appears
24 and inserting "financial institutions" in lieu thereof.

1 SEC. 123. (a) Section 10(b) of the Federal Deposit In-
2 surance Act (12 U.S.C. 1820(b)) is amended—

3 (1) by striking out “nonmember bank” in the first
4 sentence each time it appears and inserting “financial
5 institution” in lieu thereof;

6 (2) by striking out “break” after “insured” each
7 time the words appear together in the first sentence
8 and inserting “financial institution” in lieu thereof;

9 (3) by inserting “or State member” after “Dis-
10 trict” in the first sentence;

11 (4) by striking out “bank” after “examination of
12 the” in the first sentence and inserting “institution” in
13 lieu thereof;

14 (5) by striking out “and” in the second sentence
15 and inserting a comma in lieu thereof;

16 (6) by inserting “any Federal association, any
17 Federal credit union, or” after “any national bank” in
18 the second sentence;

19 (7) by striking out “bank” after “condition of any
20 such” in the second sentence and inserting “institu-
21 tion” in lieu thereof; and

22 (8) by striking out “banks” when it appears in the
23 third sentence and inserting “financial institutions” in
24 lieu thereof.

1 (b) Section 10(c) of the Federal Deposit Insurance Act
2 (12 U.S.C. 1820(c)) is amended—

3 (1) by striking out “banks, State nonmember
4 banks or other” and inserting “financial institutions” in
5 lieu thereof;

6 (2) by striking out “banks” after “become in-
7 sured” and inserting “financial,” in lieu thereof; and

8 (3) by striking out “banking” after “Federal” and
9 inserting “financial institution” in lieu thereof.

10 (c) Section 10(d) of the Federal Deposit Insurance Act
11 (12 U.S.C. 1820(d)) is amended by striking out “bank” at the
12 end of the section and adding “financial institution” in lieu
13 thereof.

14 SEC. 124(a). Section 11(a) of the Federal Deposit Insur-
15 ance Act (12 U.S.C. 1821(a)) is amended—

16 (1) by revising subsection (a)(1) to read as follows:

17 “(a)(1) The Primary Reserve and the Secondary Re-
18 serve of the Federal Savings and Loan Insurance Corpora-
19 tion, as established in section 404 of the National Housing
20 Act, are consolidated with the Federal Deposit Insurance
21 Fund to be used for the insuring of deposits, and the assets of
22 the combined funds shall be held by the Corporation for the
23 uses and purposes of the Corporation. Effective January 1,
24 1985, the National Credit Union Share Insurance Fund, as
25 established in section 203 of the Federal Credit Union Act,

1 shall be consolidated with the Federal Deposit Insurance
2 Fund to be used for the insuring of deposits, and the assets of
3 the combined funds shall be held by the Corporation for the
4 uses and the purposes of the Corporation. The obligations to
5 and rights of the Federal Savings and Loan Insurance Corpo-
6 ration and the National Credit Union Share Insurance Fund
7 arising before the effective dates of the consolidation of the
8 insurance funds shall be unimpaired and shall be assumed by
9 the Corporation. Obligations to and rights of depositors, in-
10 sured institutions and other persons arising with respect to
11 the insurance funds and arising out of any event or transac-
12 tion prior to the effective date of the transfer of the appropri-
13 ate insurance fund shall be assumed by the Corporation and
14 shall be unimpaired. Except as provided in paragraph (2), the
15 maximum amount of the insured deposit of any depositor
16 shall be \$100,000.”;

17 (2) by striking out “bank” in every place it ap-
18 pears and inserting “financial institution” in lieu there-
19 of; and

20 (3) by revising subsection (a)(2)(A)(iv) to read as
21 follows:

22 “(iv) an officer, employee, or agent of the Com-
23 monwealth of Puerto Rico, the Northern Mariana
24 Islands, any territory (including trust territories) or
25 possession of the United States (including the Virgin

1 Islands, American Samoa, and Guam) or the Panama
2 Canal Zone, or of any county, municipality, or political
3 subdivision thereof having official custody of public
4 funds and lawfully investing or depositing the same in
5 time and savings deposits in an insured financial insti-
6 tution in the Commonwealth of Puerto Rico, the
7 Northern Mariana Islands, any territory or possession
8 of the United States (including the Virgin Islands,
9 American Samoa, and Guam) and the Panama Canal
10 Zone, respectively; or”.

11 (b) Section 11(b) of the Federal Deposit Insurance Act
12 (12 U.S.C. 1821(b)) is amended by striking out “bank” in
13 every place in which it appears and inserting “financial insti-
14 tution” in lieu thereof.

15 (c) Section 11(c) of the Federal Deposit Insurance Act
16 (12 U.S.C. 1821(c)) is amended—

17 (1) by striking out “bank” in every place in which
18 it appears and inserting “financial institution” in lieu
19 thereof;

20 (2) by redesignating subsection (c) as “(c)(1)”;

21 (3) by adding a new subsection (c)(2) to read as
22 follows:

23 “(2) Notwithstanding any other provision of law, when-
24 ever the Federal Home Loan Bank Board shall appoint a
25 receiver other than a conservator of any insured Federal as-

1 society hereafter closed, it shall appoint the Corporation as
2 receiver.”; and

3 (4) by adding a new subsection (c)(3) to read as
4 follows:

5 “(3) Notwithstanding any other provision of law, effective
6 January 1, 1985, whenever the National Credit Union
7 Administration Board shall appoint a receiver of any insured
8 Federal credit union thereafter closed, it shall appoint the
9 Corporation as receiver.”.

10 (d) Section 11(d) of the Federal Deposit Insurance Act
11 (12 U.S.C. 1821(d)) is amended—

12 (1) by striking out “bank” in the three places in
13 which it appears in the first sentence and inserting “in-
14 stitution” in lieu thereof;

15 (2) by striking out “pursuant to section 5235 of
16 the Revised Statutes (12 U.S.C. 193)” in the first sen-
17 tence;

18 (3) by inserting after “national banks,” in the first
19 sentence the following: “Federal associations, or Fed-
20 eral credit unions, as the case may be,”;

21 (4) by striking out “the period of advertisement
22 made pursuant to the aforesaid section of the Revised
23 Statutes,” in the third sentence and inserting “any
24 necessary period of advertisement,” in lieu thereof;

1 (5) by striking out "or District bank" in the
2 fourth sentence and inserting ", a Federal association,
3 or a Federal credit union, as appropriate" in lieu
4 thereof;

5 (6) by striking out "bank" in the fourth sentence
6 and inserting "institution" in lieu thereof; and

7 (7) by striking out "or the Comptroller of the
8 Currency." in the fourth sentence and inserting ", the
9 Comptroller of the Currency, the Federal Home Loan
10 Bank Board, or the National Credit Union Administra-
11 tion Board." in lieu thereof.

12 (e) Section 11(e) of the Federal Deposit Insurance Act
13 (12 U.S.C. 1821(e)) is amended—

14 (1) by striking out "bank (except a District bank)"
15 in the first sentence and inserting "financial institu-
16 tion" in lieu thereof;

17 (2) by striking out "bank" the last (third) place it
18 appears in the first sentence and inserting "institution"
19 in lieu thereof; and

20 (3) by striking out "bank" in the first and third
21 places it appears in the second sentence and inserting
22 "financial institution" in lieu thereof.

23 (f) Section 11(f) of the Federal Deposit Insurance Act
24 (12 U.S.C. 1821(f)) is amended—

1 (1) by striking out "bank" in the fourth place in
2 which it appears and inserting "institution" in lieu
3 thereof; and

4 (2) by striking out "bank" in the first and fourth
5 places in which it appears and inserting "financial in-
6 stitution" in lieu thereof;

7 (g) Section 11(g) of the Federal Deposit Insurance Act
8 (12 U.S.C. 1821(g)) is amended—

9 (1) by striking out "or District bank" in the first
10 sentence and inserting "Federal association or Federal
11 credit union" in lieu thereof;

12 (2) by striking out "bank" in the third place it ap-
13 pears in the first sentence and in the first place it ap-
14 pears in the second sentence and inserting "financial
15 institution" in lieu thereof;

16 (3) by striking out "bank" in the second place it
17 appears in the second sentence and inserting "institu-
18 tion" in lieu thereof;

19 (4) by striking out "": *Provided*, That, with respect
20 to any bank which closes after May 25, 1938, the" in
21 the third sentence and inserting ". The" in lieu there-
22 of;

23 (5) by striking out "": *Provided further*, That the"
24 in the fourth sentence and inserting ". The" in lieu
25 thereof;

1 (6) by striking out "bank" in the first place it ap-
2 pears in the third sentence and in the first place it ap-
3 pears in the fifth sentence and inserting "financial in-
4 stitution" in lieu thereof; and

5 (7) by striking out "bank" in the second place it
6 appears in the third sentence and in the first and
7 second places in which it appears in the fourth sen-
8 tence and inserting "institution" in lieu thereof.

9 (h) Section 11(h) of the Federal Deposit Insurance Act
10 (12 U.S.C. 1821(h)) is amended—

11 (1) by inserting after "bank" the first place it ap-
12 pears in the first sentence the following: "or an insured
13 association,";

14 (2) by striking out "bank" in the second and
15 fourth places in which it appears in the first sentence
16 and in every place it appears in the second sentence
17 and inserting "institution" in lieu thereof; and

18 (3) by inserting after "bank" in the second place
19 in which it appears in the first sentence the following:
20 "or a new Federal association".

21 (i) Section 11(i) of the Federal Deposit Insurance Act
22 (12 U.S.C. 1821(i)) is amended—

23 (1) by striking out "national banking associations"
24 in the fourth sentence and inserting "a national bank
25 or a federal association" in lieu thereof;

1 (2) by inserting after "Comptroller of the Curren-
2 cy" in the eighth sentence the following: "or the Fed-
3 eral Home Loan Bank Board, as the case may be";

4 (3) by striking out "bank" in the first and third
5 sentences and inserting "institution" in lieu thereof;

6 (4) by striking out "bank" in the first place in
7 which it appears in the fourth sentence and inserting
8 "institution" in lieu thereof;

9 (5) by striking out "bank" in the first and second
10 places in which it appears in the fifth sentence and in-
11 serting "institution" in lieu thereof;

12 (6) by striking out "bank" in the fifth sentence
13 and inserting "financial institution" in lieu thereof;

14 (7) by striking out "bank" in the first place in
15 which it appears in the sixth sentence and inserting
16 "institution" in lieu thereof;

17 (8) by striking out "bank" in the first place in
18 which it appears in the sixth sentence and inserting
19 "financial institution" in lieu thereof;

20 (9) by striking out "bank" in the first place in
21 which it appears in the seventh sentence and inserting
22 "institution" in lieu thereof;

23 (10) by striking out "bank" in the second place in
24 which it appears in the seventh sentence and inserting
25 "financial institution" in lieu thereof;

1 (11) by striking out "bank" in the eighth sentence
2 and inserting "institution" in lieu thereof; and

3 (12) by striking out "bank" in the ninth sentence
4 and inserting "institution" in lieu thereof.

5 (j) Section 11(j) of the Federal Deposit Insurance Act
6 (12 U.S.C. 1821(j)) is amended by striking out "bank" in
7 every place in which it appears and inserting "institution" in
8 lieu thereof.

9 (k) Section 11(k) of the Federal Deposit Insurance Act
10 (12 U.S.C. 1821(k)) is amended—

11 (1) by striking out "but in no event less than that
12 required by section 5138 of the Revised Statutes, as
13 amended (12 U.S.C. 51)," in the first sentence;

14 (2) by deleting the second sentence;

15 (3) by inserting after "Comptroller of the Curren-
16 cy" in the second sentence the following: "or the Fed-
17 eral Home Loan Bank Board";

18 (4) by inserting after "national bank" in the first
19 place in which it appears in the second sentence the
20 following: "or a Federal association, as the case may
21 be,";

22 (5) by inserting after "national bank" in the
23 second place it appears in the second sentence the fol-
24 lowing: "or a Federal association";

1 (6) by inserting after "national bank" in the third
2 place in which it appears in the second sentence the
3 following: "or Federal association, as the case may
4 be.";

5 (7) by inserting after "national bank" in the third
6 sentence the following: "or a Federal association";

7 (8) by striking out "national bank" in the first
8 sentence and inserting "financial institution" in lieu
9 thereof;

10 (9) by striking out "bank" in the three places in
11 which it appears in the first sentence and inserting "in-
12 stitution" in lieu thereof;

13 (10) by striking out "he shall issue to the bank"
14 in the second sentence and inserting "the institution
15 shall be granted" in lieu thereof;

16 (11) by striking out "bank" in the first, fourth,
17 and fifth places in which it appears and inserting "in-
18 stitution" in lieu thereof; and

19 (12) by striking out "bank" in the first place in
20 which it appears in the third sentence and inserting
21 "institution" in lieu thereof.

22 (l) Section 11(l) of the Federal Deposit Insurance Act
23 (12 U.S.C. 1821(l)) is amended—

24 (1) by striking out the fourth sentence thereof;

1 (2) by inserting after "Comptroller of the Curren-
2 cy" in the first place in which it appears in the second
3 sentence the following: "or the Federal Home Loan
4 Bank Board, whichever is appropriate";

5 (3) by inserting after "Comptroller of the Curren-
6 cy" in the second place in which it appears in the
7 second sentence the following: "or the Federal Home
8 Loan Bank Board";

9 (4) by striking out "bank" in the third place in
10 which it appears in the first sentence and inserting "fi-
11 nancial institution" in lieu thereof;

12 (5) by striking out "bank" in every place in which
13 it appears in the first sentence and inserting "institu-
14 tion" in lieu thereof;

15 (6) by striking out "bank" in the second place in
16 which it appears in the second sentence and inserting
17 "financial institution" in lieu thereof; and

18 (7) by striking out "bank" in every place in which
19 it appears in the second and third sentences and insert-
20 ing "institution" in lieu thereof.

21 SEC. 125. (a) Section 12(a) of the Federal Deposit In-
22 surance Act (12 U.S.C. 1822(a)) is amended (1) by striking
23 out "or District bank" and inserting ", Federal association,
24 or Federal credit union" in lieu thereof.

1 (b) Section 12(b) of the Federal Deposit Insurance Act
2 (12 U.S.C. 1822(b)) is amended—

3 (1) by striking out “bank” in the first and third
4 places in which it appears and inserting “institution”
5 in lieu thereof; and

6 (2) by striking out “bank” in every place in which
7 it appears and inserting “financial institution” in lieu
8 thereof.

9 (c) Section 12(c) of the Federal Deposit Insurance Act
10 (12 U.S.C. 1822(c)) is amended—

11 (1) by striking out “bank” in the second place in
12 which it appears and inserting “financial institution” in
13 lieu thereof; and

14 (2) by striking out “bank” in every place in which
15 it appears and inserting “institution” in lieu thereof.

16 (d) Section 12(d) of the Federal Deposit Insurance Act
17 (12 U.S.C. 1822(d)) is amended by striking out “bank” in
18 every place in which it appears and inserting “institution” in
19 lieu thereof.

20 (e) Section 12(e) of the Federal Deposit Insurance Act
21 (12 U.S.C. 1822(e)) is amended—

22 (1) by striking out “bank” in the fourth and sixth
23 places in which it appears and inserting “financial in-
24 stitution” in lieu thereof; and

1 (2) by striking out "bank" in every place in which
2 it appears and inserting "institution" in lieu thereof.

3 SEC. 126. (a) Section 13(b) of the Federal Deposit In-
4 surance Act (12 U.S.C. 1823(b)) is amended—

5 (1) by striking out "bank" the second, third,
6 fourth, and fifth places it appears in the first sentence
7 and inserting "financial institution" in lieu thereof; and

8 (2) by striking out "banks" in the first sentence
9 and inserting "financial institutions" in lieu thereof.

10 (b) Section 13(c) of the Federal Deposit Insurance Act
11 (12 U.S.C. 1823(c)) is amended to read:

12 “(c)(1) In order to reopen a closed insured financial in-
13 stitution or, when the Corporation has determined that an
14 insured financial institution is in danger of closing, in order to
15 prevent such closing, the Corporation, in the discretion of its
16 Board of Directors, is authorized to make loans to, or pur-
17 chase the assets of, or make deposits in, such insured finan-
18 cial institution, upon such terms and conditions as the Board
19 of Directors may prescribe, when in the opinion of the Board
20 of Directors the continued operation of the financial institu-
21 tion is essential to provide adequate banking service in the
22 community.

23 “(2) Whenever severe financial conditions exist which
24 threaten the stability of a significant number of insured finan-
25 cial institutions, the Corporation, in the discretion of its

1 Board of Directors, is authorized to make loans to, or pur-
2 chase the assets of or make deposits in, any insured financial
3 institution so threatened, upon such terms and conditions as
4 the Board of Directors may prescribe, if it is probable such
5 action will substantially reduce the risk of loss or avert a
6 threatened loss to the Corporation.

7 “(3) Any loans and deposits made pursuant to the provi-
8 sions of this paragraph may be in subordination to the rights
9 of depositors and other creditors.”.

10 (c) Section 13(d) of the Federal Deposit Insurance Act
11 (12 U.S.C. 1823(d)) is amended—

12 (1) by striking out “banks” each place it appears
13 in the first and second sentences and inserting “finan-
14 cial institutions” in lieu thereof;

15 (2) by striking out the third sentence; and

16 (3) by striking out “bank” and “banks” in the
17 fourth sentence and inserting “financial institution”
18 and “financial institutions”, respectively, in lieu there-
19 of.

20 (d) Sections 13 (e) and (f) of the Federal Deposit Insur-
21 ance Act (12 U.S.C. 1823 (e) and (f)) are amended—

22 (1) by striking out the first paragraph of section
23 13(e) and inserting in lieu thereof:

24 “(e)(1) Whenever in the judgment of the Board of Direc-
25 tors such action will reduce the risk of loss or avert a threat-

1 ened loss to the Corporation and will facilitate a merger or
2 consolidation of an insured financial institution with another
3 insured financial institution or will facilitate the sale of the
4 assets of an open or closed insured financial institution to and
5 assumption of its liabilities by another insured financial insti-
6 tution, the Corporation may, upon such terms and conditions
7 as it may determine, make loans secured in whole or in part
8 by assets of an open or closed insured financial institution,
9 which loans may be in subordination to the rights of deposi-
10 tors and other creditors, or the Corporation may purchase
11 any such assets or may guarantee any other insured financial
12 institution against loss by reason of its assuming the liabil-
13 ities and purchasing the assets of an open or closed insured
14 financial institution. Any insured national bank, insured Fed-
15 eral association, District bank, or the Corporation as receiver
16 thereof, is authorized to contract for such sales or loans and
17 to pledge any assets of the financial institution to secure such
18 loans.

19 “(2)(A) As used in this paragraph (2)—(i) the term ‘re-
20 ceiver’ shall mean the Corporation when it has been appoint-
21 ed the receiver of a closed insured bank; (ii) the term
22 ‘insured depository institution’ shall mean an insured bank or
23 an insured association; (iii) the term ‘existing in-State insured
24 depository institution’ shall mean an insured depository insti-
25 tution that is chartered in the same State as the State in

1 which the closed bank was chartered; (iv) the term 'in-State
2 bank holding company' shall mean a bank holding company
3 whose banking subsidiaries' operations are principally con-
4 ducted in the same State as the State in which the closed
5 bank was chartered; and (v) the term 'out-of-State bank or
6 bank holding company' shall mean an insured bank having its
7 principal place of banking business in a State other than the
8 State in which the closed bank was chartered or a bank hold-
9 ing company whose banking subsidiaries' operations are prim-
10 cipally conducted in a State other than the State in which the
11 closed bank was chartered.

12 “(B) Whenever an insured bank that had total assets
13 equal to or greater than 0.12 percent of aggregate assets in
14 domestic (United States) offices of insured banks (as deter-
15 mined from the most recently compiled reports of condition
16 filed by insured banks) is closed and the Corporation is ap-
17 pointed receiver, then, the receiver may, in its discretion and
18 upon such terms and conditions as it may determine, and
19 with such approvals as may elsewhere be required by any
20 State or Federal courts and supervisory agencies, sell assets
21 of the closed bank to and arrange for the assumption of the
22 liabilities of the closed bank by an insured depository institu-
23 tion located in the same State as that in which the closed
24 bank was chartered but owned by an out-of-State insured
25 depository institution, bank holding company or savings and

1 loan holding company. Notwithstanding subsection (d) of sec-
2 tion 3 of the Bank Holding Company Act of 1956 or any
3 other provision of law, State or Federal, the acquiring insti-
4 tution is authorized to be and shall be operated as a subsidi-
5 ary; except that an insured depository institution may oper-
6 ate the assuming institution as a subsidiary only if specifically
7 authorized by law other than this paragraph. The expiration
8 of the effectiveness of this paragraph 2 shall have no effect
9 on the continued legality of any sale or operation authorized
10 while it was effective.

11 “(C) In determining whether to arrange a sale of assets
12 and assumption of liabilities of a closed insured bank under
13 the authority of this paragraph (2), the receiver may solicit
14 such offers as is practicable from any prospective purchasers
15 it determines, in its sole discretion, are both qualified and
16 capable of acquiring the assets and the liabilities of the closed
17 bank—

18 “(i) if, after receiving offers, the highest accept-
19 able offer is from a subsidiary of an out-of-State de-
20 pository institution or holding company, the receiver
21 shall permit the highest acceptable offeror of any exist-
22 ing in-State insured depository institutions and subsid-
23 iaries of in-State holding companies to submit a new
24 offer for the assets and liabilities of the closed bank. If
25 this institution reoffers a greater amount than the pre-

1 vious highest acceptable offer, then the receiver shall
2 sell the assets and transfer the liabilities of the closed
3 bank to that institution;

4 “(ii) if there is no acceptable offer received from
5 an existing in-State institution or subsidiary of an in-
6 State holding company or if there is no reoffer greater
7 than the highest acceptable offer, then the receiver
8 shall permit the highest acceptable offeror of the sub-
9 sidiaries of the insured depository institution chartered
10 in States adjoining the State in which the closed bank
11 was chartered and holding companies whose financial
12 subsidiaries’ operations are principally conducted in
13 States adjoining the State in which the closed bank
14 was chartered (if its offer was not the highest received
15 by the receiver) to make a new offer for the assets and
16 liabilities of the closed bank. If this subsidiary reoffers
17 a greater amount than the previous highest acceptable
18 offer, then the receiver shall sell the assets and trans-
19 fer the liabilities of the closed bank to that institution;
20 and

21 “(iii) if no offer under subparagraphs (i) or (ii) is
22 received which exceeds the original highest acceptable
23 offer, then the receiver shall sell the assets and trans-
24 fer the liabilities of the closed bank to the highest ac-
25 ceptable offeror.

1 “(D) In making a determination to solicit offers under
2 subparagraph (C), the State bank supervisor of the State in
3 which the closed insured bank was chartered shall be con-
4 sulted. The State bank supervisor shall be given a reasonable
5 opportunity, and in no instance a period of less than twenty-
6 four hours, to object to the use of the provisions of this para-
7 graph (2). If the State supervisor objects, the receiver may
8 use the authority of this paragraph (2) only by a unanimous
9 vote of the Board of Directors. The Board of Directors shall
10 provide to the State supervisor, as soon as practicable, a
11 written certification of its determination.

12 “(E) The receiver shall not make any sale under the
13 provisions of this paragraph (2)—(i) which would result in a
14 monopoly, or which would be in furtherance of any combina-
15 tion or conspiracy to monopolize or to attempt to monopolize
16 the business of banking in any part of the United States; or
17 (ii) whose effect in any section of the country may be sub-
18 stantially to lessen competition, or to tend to create a monop-
19 oly, or which in any other manner would be in restraint of
20 trade, unless it finds that the anticompetitive effects of the
21 proposed transaction are clearly outweighed in the public in-
22 terest by the probable effect of the transaction in meeting the
23 convenience and needs of the community to be served.

1 “(F) Nothing contained in this paragraph (2) shall be
2 construed to limit the Corporation’s powers in paragraph (1)
3 to assist a transaction under this paragraph.”.

4 (2) by striking out “bank” each place it appears
5 in the second paragraph of section 13(e) as amended
6 and inserting “financial institution” in lieu thereof; and

7 (3) by striking out the language in section 13(f)
8 and inserting the second paragraph of 13(e) in lieu
9 thereof.

10 (e) Section 13(g) of the Federal Deposit Insurance Act
11 (12 U.S.C. 1823(g)) is amended by striking out “bank” the
12 first and second places it appears and inserting “financial in-
13 stitution” in lieu thereof.

14 SEC. 127. Section 14 of the Federal Deposit Insurance
15 Act is amended—

16 (1) by changing the last sentence to read: “All
17 loans from and repayments to the Treasury shall be
18 treated as public debt transactions of the United
19 States.”; and

20 (2) by adding at the end a new sentence to read:
21 “This section shall not prevent the Corporation from
22 borrowing from any Federal Reserve Bank or Federal
23 Home Loan Bank on such terms as may be fixed by
24 the Board of Directors of the Corporation and the
25 Board of Governors of the Federal Reserve System or

1 the Federal Home Loan Bank Board, as is appropri-
2 ate.”.

3 SEC. 128. Section 15 of the Federal Deposit Insurance
4 Act (12 U.S.C. 1825) is amended by deleting the first sen-
5 tence of the section.

6 SEC. 129. Section 16 of the Federal Deposit Insurance
7 Act (12 U.S.C. 1826) is repealed.

8 SEC. 130. Section 17(b) of the Federal Deposit Insur-
9 ance Act (12 U.S.C. 1827(b)) is amended by deleting the fifth
10 sentence.

11 SEC. 131. Section 18 of the Federal Deposit Insurance
12 Act (12 U.S.C. 1828) is amended—

13 (1) by striking out “bank” each place it appears
14 in subsections (a) and (b) and inserting “financial insti-
15 tution” in lieu thereof;

16 (2) by striking out “bank or” in clause (A) of sub-
17 section (c)(1) and inserting “financial” in lieu thereof;

18 (3) by striking out the semicolon at the end of
19 clause (A) of subsection (c)(1) and adding the following:
20 “or other institution;”;

21 (4) by striking out “bank or” in clause (B) of sub-
22 section (c)(1) and inserting “financial” in lieu thereof;

23 (5) by striking out the semicolon at the end of
24 clause (B) of subsection (c)(1) and adding the following:
25 “or other institution;”;

1 (6) by striking out "bank or institution" in clause
2 (C) of subsection (c)(1) and inserting "financial institu-
3 tion or other institution" in lieu thereof;

4 (7) by striking out "bank." the last place it ap-
5 pears in clause (C) of subsection (c)(1) and inserting
6 "financial institution." in lieu thereof;

7 (8) by striking out "bank" each place it appears
8 in subsection (c)(2) and inserting "financial institution"
9 in lieu thereof;

10 (9) by striking out "bank" the first place it ap-
11 pears in clause (C) of subsection (c)(2) and inserting
12 "institution" in lieu thereof;

13 (10) by striking out "bank" the second place it
14 appears in clause (C) of subsection (c)(2) and inserting
15 "institution" in lieu thereof;

16 (11) by striking out the period at the end of
17 clause (C) of subsection (c)(2) and inserting a semicolon
18 in lieu thereof;

19 (12) by adding after clause (C) of subsection (c)(2)
20 the following:

21 "(D) the Federal Home Loan Bank Board if the
22 acquiring, assuming, or resulting institution is to be a
23 Federal association."

24 (13) by adding after the last clause of subsection
25 (c)(2) the following paragraph:

1 “Prior written approval shall not be required under this
2 subsection, however, of a proposed transaction if one of the
3 parties is a bank or other corporation that is nonoperating
4 and newly chartered, the proposed transaction is pro forma
5 and in itself of no significance under the factors set forth in
6 paragraph (5), but is employed as a means to facilitate, and
7 its consummation is conditioned upon, the lawful acquisition
8 of bank stock or of the stock of a savings and loan associ-
9 ation, which acquisition is the subject of an application under
10 section 3 of the Bank Holding Company Act of 1956 (12
11 U.S.C. 1842) or under section 408 of the National Housing
12 Act (12 U.S.C. 1730a), and the material details of the pro-
13 posed transaction are fully disclosed in that application.”.

14 (14) by striking out “banks” the first place it ap-
15 pears in subsection (c)(3) and inserting “institutions” in
16 lieu thereof;

17 (15) by striking out “banks” in clause (D) of sub-
18 section (c)(3) and inserting “institutions” in lieu there-
19 of;

20 (16) by striking out “banks” the first place it ap-
21 pears in subsection (c)(4) and inserting “financial insti-
22 tutions” in lieu thereof;

23 (17) by striking out “request reports” the first
24 place it appears in subsection (c)(4) and inserting “re-
25 quest a report” in lieu thereof;

1 (18) by inserting a period after "Attorney Gener-
2 al" the first place it appears in subsection (c)(4) and by
3 striking out "and the other two banking agencies re-
4 ferred to in this subsection.";

5 (19) by striking out "reports" in the second sen-
6 tence of subsection (c)(4) and inserting "report" in lieu
7 thereof;

8 (20) by striking out "they are" in the second sen-
9 tence of subsection (c)(4) and inserting "it is" in lieu
10 thereof;

11 (21) by striking out "and the other two banking
12 agencies" in the second sentence of subsection (c)(4);

13 (22) by striking out "the business of banking" in
14 clause (A) of subsection (c)(5) and inserting "any part
15 of trade or commerce" in lieu thereof;

16 (23) by striking out "banks" in the second sen-
17 tence of subsection (c)(6) and inserting "institutions" in
18 lieu thereof;

19 (24) by striking out "reports on the competitive
20 factors have" in the second sentence of subsection
21 (c)(6) and inserting "the competitive factors report
22 has" in lieu thereof;

23 (25) by striking out "and the other two banking
24 agencies" in the third sentence of subsection (c)(6);

1 (26) by striking out "reports" in the third sen-
2 tence of subsection (c)(6) and inserting "a report" in
3 lieu thereof;

4 (27) by striking out "banking" the last place it
5 appears in clause (D) of subsection (c)(7);

6 (28) by striking out subsection (c)(9) and (c)(10),
7 which are hereby repealed;

8 (29) by redesignating subsection "(c)(11)" as sub-
9 section "(c)(10)";

10 (30) by striking out "bank" the first and third
11 places it appears in subsection (d)(1) and the first place
12 it appears in subsection (d)(2) and inserting "financial
13 institution" in lieu thereof;

14 (31) by striking out "bank" each place it appears
15 in subsection (e) and inserting "financial institution" in
16 lieu thereof;

17 (32) by striking out "bank" the first, third, and
18 fourth places it appears in subsection (f) and inserting
19 "financial institution" in lieu thereof;

20 (33) by striking out "banks" in subsection (g)(1)
21 the first place it appears in the first sentence and the
22 first place it appears in the tenth sentence and insert-
23 ing "financial institutions" in lieu thereof;

24 (34) by striking out "banks" in subsection (g)(1)
25 as it appears in the fifth sentence and, at the last place

1 it appears in the seventh sentence, and inserting “fi-
2 nancial institution” in lieu thereof;

3 (35) by striking out “bank” at the place it ap-
4 pears in the eighth sentence of subsection (g)(1) and in-
5 serting “institution” in lieu thereof;

6 (36) by striking out “bank” at the places it ap-
7 pears in the twelfth sentence of subsection (g)(1) and
8 inserting “financial institution” in lieu thereof;

9 (37) by striking out “bank” at the places it ap-
10 pears in subsection (g)(2) and inserting “financial insti-
11 tution” in lieu thereof;

12 (38) by striking out the ninth and eleventh sen-
13 tences of subsection (g)(1);

14 (39) by striking out “bank” in subsection (h) and
15 inserting “financial institution” in lieu thereof;

16 (40) by striking out “bank” the first place it ap-
17 pears in subsection (i)(1) and inserting “financial insti-
18 tution” in lieu thereof;

19 (41) by striking out “bank” the first three places
20 it appears in subsection (i)(2) and inserting “financial
21 institution” in lieu thereof;

22 (42) by striking out “banks” and inserting “bank”
23 in lieu thereof in clause (B) of subsection (i)(2);

1 (43) by striking out "bank" the second place it
2 appears in clause (C) of subsection (i)(2) and inserting
3 "financial institution" in lieu thereof;

4 (44) by striking out "bank" the first place it ap-
5 pears in subsection (i)(3) and inserting "financial insti-
6 tution" in lieu thereof;

7 (45) by striking out "bank or institution" at the
8 end of subsection (i)(3) and inserting "financial institu-
9 tion or other institution." in lieu thereof;

10 (46) by striking out "bank" in clause (A) of sub-
11 section (i)(4) and inserting "institution" in lieu thereof;

12 (47) by striking out "bank" in the first sentence
13 of subsection (j)(1) the first, second, fourth and seventh
14 places it appears and inserting "financial institution" in
15 lieu thereof;

16 (48) by striking out "bank" the fifth place it ap-
17 pears in the first sentence of subsection (j)(1) and in-
18 serting "institution" in lieu thereof;

19 (49) by striking out "bank" the fourth and fifth
20 places it appears in subsection (j)(2) and inserting "fi-
21 nancial institution" in lieu thereof;

22 (50) by striking out "bank" the two places it ap-
23 pears in the first sentence of subsection (j)(3)(A) and in-
24 serting "financial institution" in lieu thereof;

1 (51) by striking out "member bank" in subsection
2 (j)(3)(B) and inserting "institution" in lieu thereof;

3 (52) by striking out "bank" in the first sentence
4 of subsection (j)(3)(C) and inserting "financial institu-
5 tion" in lieu thereof;

6 (53) by striking out "bank" in the first sentence
7 of subsection (j)(3)(D) and in the first sentence of sub-
8 section (j)(3)(E) and inserting "financial institution" in
9 lieu thereof;

10 (54) by striking out "bank" each place it appears
11 in subsection (k) and inserting, "financial Institution"
12 in lieu thereof the first place it appears, and by insert-
13 ing "institution" in lieu thereof the second, third and
14 fourth place it appears;

15 (55) by striking out "bank" the first place it ap-
16 pears in subsection (1) and inserting "financial institu-
17 tion" in lieu thereof;

18 (56) by striking out "banks" in the first place it
19 appears in subsection (1) and inserting "institutions" in
20 lieu thereof.

21 SEC. 132. Section 19 of the Federal Deposit Insurance
22 Act (12 U.S.C. 1829) is amended to read as follows:

23 "SEC. 19. (a) Except with the written consent of the
24 appropriate Federal financial institution agency, no person
25 shall serve as a director or officer of any insured financial

1 institution who has been convicted, or who is hereafter con-
2 victed, of any criminal offense involving dishonesty or breach
3 of trust which is punishable by imprisonment for a term ex-
4 ceeding one year under State or Federal law.

5 “(b) Any person whose employment is prohibited pursuant
6 to paragraph (a) may request in writing an opportunity to
7 appear before the appropriate agency to show that his or her
8 employment does not, or is not likely, to pose a threat to the
9 interests of an institution in general. Upon receipt of any
10 such request, the appropriate Federal financial institution
11 agency within a reasonable period shall provide the individual
12 with a hearing, the agency shall notify the individual of its
13 determination whether the individual may be employed by a
14 specific financial institution. Such notification shall contain a
15 statement of the basis for the agency’s decision, if adverse to
16 the individual.

17 “(c)(1) For each willful violation of the prohibition con-
18 tained in paragraph (a), the financial institution involved shall
19 be subject to a penalty of not more than \$1,000 for each day
20 this prohibition is violated. The penalty shall be assessed and
21 collected by the appropriate Federal financial institution
22 agency by written notice.

23 “(2) In determining the amount of the penalty the ap-
24 propriate Federal financial institution agency shall take into
25 account the appropriateness of the penalty with respect to

1 the size of financial resources and good faith of the insured
2 financial institution, the gravity of the violation, the history
3 of previous violations, and such other matters as justice may
4 require.

5 “(3) The insured financial institution assessed shall be
6 afforded an opportunity for agency hearing, upon request
7 made within ten days after issuance of the notice of assess-
8 ment. In such hearing all issues shall be determined on the
9 record pursuant to section 554 of title 5, United States Code.
10 The agency determination shall be made by final order which
11 may be reviewed only as provided in subparagraph (4). If no
12 hearing is requested as herein provided, the assessment shall
13 constitute a final and unappealable order.

14 “(4) Any insured financial institution against whom an
15 order imposing a civil money penalty has been entered after
16 agency hearing under this section may obtain review by the
17 United States court of appeals for the circuit in which the
18 home office of the insured bank is located, or the United
19 States Court of Appeals for the District of Columbia Circuit,
20 by filing a notice of appeal in such court within ten days from
21 the date of such order, and simultaneously sending a copy of
22 such notice by registered or certified mail to the appropriate
23 Federal financial institution agency. The agency shall
24 promptly certify and file in such Court the record upon which
25 the penalty was imposed, as provided in section 2112 of title

1 28, United States Code. The findings of the agency shall be
2 set aside if found to be unsupported by substantial evidence
3 as provided by section 706(2)(E) of title 5, United States
4 Code.

5 “(5) If any insured financial institution fails to pay an
6 assessment after it has become a final and unappealable
7 order, or after the court of appeals has entered final judgment
8 in favor of the agency, the agency shall refer the matter to
9 the Attorney General, who shall recover the amount assessed
10 by action in the appropriate United States district court. In
11 such action, the validity and appropriateness of the final
12 order imposing the penalty shall not be subject to review.

13 “(6) All penalties collected under authority of this sec-
14 tion shall be covered into the Treasury of the United States.

15 “(d) Each Federal financial institution agency shall pro-
16 mulgate regulations establishing procedures necessary to im-
17 plement this section.”.

18 SEC. 133. (a) Section 20 of the Federal Deposit Insur-
19 ance Act (12 U.S.C. 1829a) is amended by replacing the
20 words “a State nonmember insured bank” every place they
21 may appear with the words “an insured financial institution”.

22 (b) Paragraph (b) of section 20 of the Federal Deposit
23 Insurance Act (12 U.S.C. 1829a(b)) is amended to read as
24 follows:

1 (b) An insured financial institution may not permit—(1)
2 the use of any part of its own offices by any person for any
3 purpose forbidden to the institution under subsection (a), or
4 (2) direct access by the public from any of its own offices to
5 any premises used by any person for any purpose forbidden to
6 the institution under subsection (a).”

7 (c) Paragraph (d) of section 20 of the Federal Deposit
8 Insurance Act (12 U.S.C. 1829a(d)) is amended by removing
9 the word “banking” after the word “lawful”.

10 (d) Paragraph (e) of section 20 of the Federal Deposit
11 Insurance Act (12 U.S.C. 1829a(e)) is amended by removing
12 the words “Board of Directors” and replacing them with the
13 words “appropriate Federal financial institution agencies”.

14 SEC. 134. Section 21 of the Federal Deposit Insurance
15 Act (12 U.S.C. 1829b) is amended by replacing the word
16 “bank” wherever it may appear with the word “financial in-
17 stitutions”.

18 SEC. 135. Section 22 of the Federal Deposit Insurance
19 Act is amended—

20 (1) by inserting “or association” after “non-
21 member banks”; and

22 (2) by striking out “banks” and “bank” when
23 they appear and inserting “financial institutions” and
24 “financial institution”, respectively, in lieu thereof.

1 SEC. 136. Section 25 of the Federal Deposit Insurance
2 Act (12 U.S.C. 1831b) is amended by replacing the words
3 “insured banks” wherever they appear with the words “in-
4 sured financial institutions” and by replacing the word
5 “bank” at the end of the first sentence of paragraph (a) and
6 in the second sentence in paragraph (a) with the word “insti-
7 tution”.

8 SEC. 137. Section 26 of the Federal Deposit Insurance
9 Act (12 U.S.C. 1831c) is hereby repealed.

10 SEC. 138. (a) Section 27(a) of the Federal Deposit In-
11 surance Act (12 U.S.C. 1831d) is amended—

12 (1) by striking out “banks, including insured sav-
13 ings banks and insured mutual savings banks,” and in-
14 serting “financial institutions” in lieu thereof; and

15 (2) by striking out “bank” the first, third, sixth,
16 and eighth place it appears and inserting “financial in-
17 stitution” in lieu thereof.

18 (b) Section 27(b) of the Federal Deposit Insurance Act
19 (12 U.S.C. 1831d) is amended by striking out “bank” the
20 first and third places it appears and inserting “financial insti-
21 tution” in lieu thereof.

22 SEC. 139. The Federal Deposit Insurance Act is
23 amended by adding a new section 28 which shall read as
24 follows:

1 “SEC. 28. (a) The time and savings deposits held by
2 insured financial institutions, to the extent they are insured
3 by the Corporation, shall be lawful investments and may be
4 accepted as securities for all public funds of the United
5 States, fiduciary and trust funds under the authority or con-
6 trol of the United States or any officer or officers thereof, and
7 for the funds of all corporations organized under the laws of
8 the United States (subject to any regulatory authority other-
9 wise applicable), regardless of any limitation of law upon the
10 investment of any such funds or upon the acceptance of secu-
11 rity for the investment or deposit of any such funds.

12 “(b) Any insured financial institution may be a deposi-
13 tary of public money and may be employed as fiscal agent of
14 the United States. The Secretary of the Treasury is author-
15 ized to deposit public money in any insured financial institu-
16 tion, and shall prescribe such regulations as may be neces-
17 sary to enable any insured financial institution to become de-
18 positories of public money and fiscal agents of the United
19 States. Each insured financial institution shall perform all
20 reasonable duties as depositories of public money and fiscal
21 agent of the United States as may be required of it including
22 services in connection with the collection of taxes and other
23 obligations owed the United States.”.

24 SEC. 140. This title shall be effective on January 1,
25 1983.

1 **TITLE II—NATIONAL HOUSING ACT**

2 **SEC. 201.** Effective January 1, 1983, sections 401
3 through 407 and sections 409 through 414 of the National
4 Housing Act (12 U.S.C. 1724–1730, 1730b–1730g) are
5 repealed.

6 **SEC. 202.** Section 408 of the National Housing Act (12
7 U.S.C. 1730a) shall be amended by replacing the word “Cor-
8 poration” wherever it appears with the word “Board”.

9 **SEC. 203.** Section 408(a)(1)(A) of the National Housing
10 Act (12 U.S.C. 1730a(a)(1)(A)) is amended to read as
11 follows:

12 “(A) ‘insured institution’ shall mean an ‘insured
13 association’ as defined in section 3 of the Federal De-
14 posit Insurance Act (12 U.S.C. 1813);”.

15 **SEC. 204.** Section 408(a)(1)(B) of the National Housing
16 Act (12 U.S.C. 1730a(a)(1)(B)) is amended to read as fol-
17 lows:

18 “(B) ‘uninsured institution’ means any association,
19 the accounts of which are not insured by the Federal
20 Deposit Insurance Corporation;”.

21 **SEC. 205.** Section 408(a)(1)(C) of the National Housing
22 Act (12 U.S.C. 1730(a)(1)(C)) is amended by replacing the
23 words “Federal Savings and Loan” with the words “Federal
24 Deposit”.

1 SEC. 206. Section 408(a)(1) of the National Housing
2 Act (12 U.S.C. 1730a(a)(1)) is amending by deleting the
3 word "and" after paragraph (I), replacing the period at the
4 end of paragraph (J) with "; and", and by adding a new
5 paragraph (K) to read as follows: "(K) 'Board' means the
6 Federal Home Loan Bank Board."

7 SEC. 207. Section 408(b)(1) of the National Housing
8 Act (12 U.S.C. 1730a(b)(1)) is amended by revising the first
9 sentence in the section to read as follows: "Each savings and
10 loan holding company registered with the Federal Savings
11 and Loan Insurance Corporation on December 31, 1982,
12 shall be registered with the Board without application; any
13 other company, within ninety days after becoming a savings
14 and loan holding company, shall register with the Board on
15 forms prescribed by the Board, which shall include informa-
16 tion, under oath or otherwise, with respect to the financial
17 condition, ownership, operations, management, and intercom-
18 pany relationships of such holding company and its subsidiar-
19 ies, and related matters, as the Board may deem necessary or
20 appropriate to carry out the purposes of this section."

21 SEC. 208. This title takes effect on January 1, 1983.

22 **TITLE III—FEDERAL CREDIT UNION ACT**

23 SEC. 301. Effective January 1, 1985, title II of the
24 Federal Credit Union Act (12 U.S.C. 1781-1790) is re-
25 pealed.

1 **TITLE IV—MISCELLANEOUS AMENDMENTS**

2 **SEC. 401.** (a) Subsection (d)(1) of section 5 of Public
3 Law 93-100 (12 U.S.C. 1470) is amended by striking out
4 “Federal Savings and Loan Insurance Corporation” and in-
5 serting “Federal Home Loan Bank Board”, by striking out
6 “insured institutions” and inserting “Federal savings and
7 loan associations”, and by striking out “nonmember insured
8 banks” and inserting “insured financial institutions”.

9 (b) Subsection (e)(1) of such section is repealed.

10 (c) Subsection (e)(2) of such section is amended by strik-
11 ing out “State nonmember insured banks” and inserting
12 “State insured nonmember financial institutions”.

13 **SEC. 402.** (a) Subsection (3) of section 2 of the Bank
14 Protection Act of 1968 (12 U.S.C. 1881) is amended by
15 striking out “banks” and inserting “financial institutions”.

16 (b) Subsection (4) of such section is amended by striking
17 out “, and institutions the accounts of which are insured by
18 the Federal Savings and Loan Insurance Corporation”.

19 **SEC. 403.** (a) Subsection (b)(1)(C) of section 305 of the
20 Home Mortgage Disclosure Act of 1975 (12 U.S.C. 2804) is
21 amended by striking out “banks” the first time it appears and
22 inserting “financial institutions”, and inserting after
23 “System” in the parenthesis “Federal credit unions and
24 financial institutions referred to in paragraph (2) of this sub-
25 section”.

1 (b) Paragraph (2) of subsection (b) is amended by strik-
2 ing out "section 1730 of this title," and "(acting directly or
3 through the Federal Savings and Loan Insurance Corpora-
4 tion)".

5 (c) Paragraph (3) of subsection (b) is amended by insert-
6 ing "Federal" immediately after "any".

7 SEC. 404. (a) Subsection (1)(C) of section 803 of the
8 Community Reinvestment Act of 1977 (12 U.S.C. 2902) is
9 amended by striking out "banks and savings banks" and in-
10 serting "financial institutions".

11 (b) Subsection (1)(D) of such section is amended by
12 striking out "institutions the deposits of which are insured by
13 the Federal Savings and Loan Insurance Corporation" and
14 inserting "Federal savings and loan association, Federal
15 mutual savings banks".

16 (c) Subsection (2) of such section is amended to read:
17 "the term 'regulated financial institution' means an insured
18 financial institution as defined in section 3 of the Federal
19 Deposit Insurance Act (12 U.S.C. 1813) other than a credit
20 union as defined in section 3 of the Federal Deposit Insur-
21 ance Act (12 U.S.C. 1813).".

22 (d) Subsection (5) of such section is amended by insert-
23 ing "Federal" after "to" and striking out "the accounts of
24 which are insured by the National Credit Union Admin-
25 istration".

1 **SEC. 405. (a) Subsection (3) of section 207 of the De-**
 2 **pository Institution Management Interlocks Act (12 U.S.C.**
 3 **3207) is amended by striking out "banks" and inserting "fi-**
 4 **nancial institutions."**

5 (b) Subsection (4) of such section is amended by striking
 6 out "institutions the accounts of which are insured by the
 7 Federal Savings and Loan Insurance Corporation", and in-
 8 serting "Federal savings and loan associations, Federal
 9 mutual savings bank".

10 (c) Subsection (5) of such section is amended by insert-
 11 ing "Federal" after "to" and striking out "the accounts of
 12 which are insured by the National Credit Union Administra-
 13 tion".

14 **SEC. 406. (a) Subsection (a)(1)(c) of section 208 of the**
 15 **Depository Institutions Deregulation Act of 1980 (12 U.S.C.**
 16 **3507) is amended by striking out "banks" and inserting "fi-**
 17 **nancial institutions", and inserting after "System" in the**
 18 **parenthesis ", Federal savings and loan associations and**
 19 **Federal mutual savings banks".**

20 (b) Subsection (a)(2) of such section is amended by in-
 21 serting "and" between "1437" and "1464(d)", and striking
 22 out ", and 1780" and "(acting directly or through the Feder-
 23 al Savings and Loan Insurance Corporation)".

1 SEC. 407. (a) Subsection (a)(1)(C) of section 108 of the
2 Truth in Lending Act (15 U.S.C. 1607) is amended by strik-
3 ing out "banks" and inserting "State financial institutions".

4 (b)(1) Subsection (a)(2) of such section is amended by
5 striking out "section 5(d) of the Home Owners' Loan Act of
6 1933", ", and sections (6)(i) and 17 of the Federal Home
7 Loan Bank Act," and "(acting directly or through the Feder-
8 al Savings and Loan Insurance Corporation),".

9 (2) Subsection (b)(2) of such section is amended by strik-
10 ing out "any of those" and inserting "its".

11 SEC. 408. (a) Subsection (b)(1)(C) of section 621 of the
12 Fair Credit Reporting Act (15 U.S.C. 1681s) is amended by
13 striking out "banks" and inserting "State financial institu-
14 tions".

15 (b)(1) Subsection (b)(2) of such section is amended by
16 striking out "section 5(d) of the Home Owners' Loan Act of
17 1933", ", and section 6(i) and 17 of the Federal Home Loan
18 Bank Act," and "(acting directly or through the Federal
19 Savings and Loan Insurance Corporation),".

20 (2) Subsection (b)(2) of such section is amended by strik-
21 ing out "any of those" and inserting "its".

22 SEC. 409. (a) Subsection (a)(1)(C) of section 704 of the
23 Equal Credit Opportunity Act (15 U.S.C. 1691c) is amended
24 by striking out "banks" and inserting "State financial institu-
25 tions".

1 (b)(1) Subsection (a)(2) of such section is amended by
2 striking out “Section 5(d) of the Home Owners’ Loan Act of
3 1933”, “, and sections 6(i) and 17 of the Federal Home Loan
4 Bank Act”, and “(acting directly or through the Federal
5 Savings and Loan Insurance Corporation)”.

6 (2) Subsection (b)(2) of such section is amended by strik-
7 ing out “any of those” and inserting “its”.

8 SEC. 410. (a) Subsection (b)(1)(C) section 814 of the
9 Fair Debt Collection Practices Act (15 U.S.C. 1692l) is
10 amended by striking out “banks” and inserting “State finan-
11 cial institutions”.

12 (b)(1) Subsection (b)(2) of such section is amended by
13 striking out “section 5(d) of the Home Owners’ Loan Act of
14 1933”, “, and sections 6(i) and 17 of the Federal Home Loan
15 Bank Act”, and “(acting directly or through the Federal
16 Savings and Loan Insurance Corporation),”.

17 (b)(2) Subsection (b)(2) of such section is amended by
18 striking out “any of those” and inserting “its”.

19 SEC. 411. (a) Subsection (a)(1)(C) of section 917 of the
20 Electronic Fund Transfer Act (15 U.S.C. 1693o) is amended
21 by striking out “banks” and inserting “State financial
22 institutions”.

23 (b)(1) Subsection (a)(2) of such section is amended by
24 striking out “section 5(d) of the Home Owners’ Loan Act of
25 1933”, “, and sections 6(i) and 17 of the Federal Home Loan

1 Bank Act", and "(acting directly or through the Federal
2 Savings and Loan Insurance Corporation),".

3 (b)(2) Subsection (a)(2) of such section is amended by
4 striking out "any of those" and inserting "its".

5 SEC. 412. Section 212 of title 18, United States Code,
6 amended by striking out "bank" and inserting "financial in-
7 stitution".

8 SEC. 413. Section 213 of title 18, United States Code,
9 is amended by striking out "banks" the second time it ap-
10 pears and inserting "financial institutions".

11 SEC. 414. Section 215 of title 18, United States Code,
12 is amended by striking out "bank" the first time it appears
13 and inserting "financial institution".

14 SEC. 415. Section 709 of title 18, United States Code,
15 is amended by striking out the third paragraph.

16 SEC. 416. (a) The first paragraph of title 18, United
17 States Code, section 1005 is amended by striking out "bank"
18 the fourth and fifth times it appears and inserting "financial
19 institution" and by striking out "banks" and inserting "finan-
20 cial institutions".

21 (b) The third paragraph of such section is amended by
22 striking out "bank" each time it appears and inserting "fi-
23 nancial institution".

24 SEC. 417. (a) Subsection (g) title 18, United States
25 Code, section 2113 is amended by striking out "Federal" and

1 “and any ‘insured institution’” and all that follows, and in-
2 serting “the deposits of which are insured by the Federal
3 Deposit Insurance Corporation.”.

4 (b) Subsection (h) of such section is amended by striking
5 out “Administration of the National Credit Union Adminis-
6 tration” and inserting “Federal Deposit Insurance
7 Corporation”.

8 SEC. 418. Section 3(a)(5) of the Flood Disaster Protec-
9 tion Act of 1973 (42 U.S.C. 4003) is amended by deleting
10 “the Federal Savings and Loan Insurance Corporation”.



FINANCIAL INSTITUTIONS RESTRUCTURING AND SERVICES ACT OF 1981

TUESDAY, OCTOBER 20, 1981

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 9:30 a.m., in room 4302 of the Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Chafee, Schmitt, Proxmire, and Dixon. The CHAIRMAN. The committee will come to order.

Today we start the second day of hearings on S. 1720 and other bills incorporated in the legislation introduced a couple of weeks ago.

We are happy to have before us Llewellyn Jenkins, president, American Bankers Association, and Robert L. McCormick, first vice president, Independent Bankers Association of America.

Mr. Jenkins, would you like to begin.

STATEMENT OF LLEWELLYN JENKINS, PRESIDENT, AMERICAN BANKERS ASSOCIATION, ACCOMPANIED BY LEE GUNDERSON, IMMEDIATE PAST PRESIDENT, AMERICAN BANKERS ASSOCIATION, CURRENT CHAIRMAN, ABA COUNCIL

Mr. JENKINS. I am Llewellyn Jenkins, president of the American Bankers Association and vice chairman of the board of the Manufacturers Hanover Trust Co. of New York City.

I am accompanied by Mr. Lee Gunderson, on my right, immediate past president of the ABA and now chairman of the ABA Council and president of the Bank of Osceola, Wis.

Thank you for placing my full statement in the record. In my brief oral presentation, I will confine myself primarily to comments on title I, parts A and B. These portions of the bill, in effect, would authorize thrift institutions to operate as if they were banks.

We commend the chairman for attempting to resolve a number of seemingly unrelated issues that in most instances clearly do point in the same direction—the opportunity for depository institutions to compete more effectively in the new competitive environment of the financial services industry.

Prior to addressing the issues involved, it is important to mention the overriding issue which if left unresolved will frustrate any attempts to address the items raised in the legislation.

The efforts this committee has put forward in securing recent budget reductions is well known and commendable. Progress has been made. The current signals from the Congress are, however, quite discouraging.

Further reduction in spending are essential. It is also vital that the Congress live up to its commitments made in the budget resolution adopted in July.

To combat the ever-widening budget deficit, our Nation can either print more money, tax its citizens and businesses ever more, or reduce the rate of spending. The latter answer is the only one that can ever lead to long-term economic stability and growth.

We urge the chairman and the members of the committee not to waiver in the determination to win this specific battle on inflation. All other issues pale in significance, and essentially are tied to this fundamental issue.

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Our association testified earlier this year on the need for legislation to address many of the items in S. 1720. We are pleased that much of what was identified in the prior hearings as necessary for banks to maintain competitive viability and get costly and unnecessary Government interference out of the middle of every banking transaction is in S. 1720.

The new issues in S. 1720 relate to the matter of dealing with current and perceived future earnings and competitive problems of the specialized thrift institutions. It is our conviction that unless banking gains competitive equity with the near banks of the securities industry, attains broader lending and investment powers, and gets feed of state-imposed usury ceilings and due-on-sale prohibitions, it is of marginal value to give the specialized thrifts more bank-like powers.

Many of these issues have been patiently awaiting resolution for many years. Changing the powers of the specialized thrifts as proposed in S. 1720 is a relatively new matter.

NEW AND CONTROVERSIAL MATTER

Another new and controversial matter, Mr. Chairman, is contained in S. 1721, the bill proposing consolidation of the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Administration's Share Insurance Fund.

The American Bankers Association cannot support S. 1721 at this time. Similar proposals were made in 1963 and in 1972, and on both occasions the ABA did not agree that consolidation was needed or would be good public policy.

We realize that conditions have changed since 1972, and further changes in the financial environment are occurring daily. We respectfully request, however, that committee action on S. 1721 be deferred until there has been additional opportunity to thoroughly

consider the need for and ramifications of this proposed consolidation. Bankers are concerned about the impact that the consolidation might have on the current FDIC fund created by assessments on banks. More data are needed and justification must be established before this proposal is acted upon.

Title I of S. 1720 would expand substantially the authority of specialized thrift institutions on both the asset and liability sides of the balance sheet. In addition, S. 1720 would facilitate conversion of specialized thrift institutions from State to Federal charter and from mutual to stock form of organization.

It is important to recognize that this proposed expansion of thrift powers will do nothing in the near term to offset earnings problems. It does nothing about the low-yielding mortgages currently held in thrift portfolios.

To utilize many of the additional powers granted in S. 1720, specialized thrifts would have to enter entirely new markets in which they currently have no experience. This would require substantial investments in personnel and customer relationships which will not begin generating profits for some time.

The competitive nature of the markets which specialized thrifts would be allowed to enter, and their lack of expertise in these markets makes it likely that at least some specialized thrifts will initially incur substantial losses.

Thus, expansion of specialized thrift institution powers will involve a period of negative cashflow for the expanding institutions, further exacerbating their immediate earnings problems. Even if it were concluded that expansion of specialized thrift institution powers might reduce the likelihood of a future recurrence of earnings problems, it would be important to postpone expansion of such powers until specialized thrifts are better able to handle the temporary negative cashflow that is likely to result.

Nevertheless, we believe controlled expansion of specialized thrift institution powers could help solve their problems and deserves further study.

However, because expansion of specialized thrift institution powers as proposed in S. 1720 will not help and, in fact, may aggravate their current earnings problems, there is no need to act on this legislation in a crisis atmosphere.

The broadened authority to offer variable rate mortgages will allow specialized thrift institutions to share interest rate risks with borrowers. Ability to trade financial futures provides the potential for them to reduce their interest rate risk. Thus, legislative action should await study of several serious issues relating to the longrun effect of such an expansion of their powers. These include competitive equity among depository institutions, the safety and soundness of the financial system, and the structure of regulatory agencies.

It should also be recognized that an important part of the so-called thrift problem has nothing to do with their competitive position vis-a-vis banks and, hence, will not be changed by altering the laws and regulations that govern that position. I am referring to the competitive problem that all depository institutions have vis-a-vis nondepository institutions.

Other parts of S. 1720 address some of the restrictions that have created this problem. However, another important aspect of this

problem, a faster and more equitable liberalization of regulation Q ceilings, can only be resolved by the Depository Institutions Deregulation Committee. A faster elimination of longer term ceilings affecting consumer certificates of deposit and a short-term deposit instrument competitive with money market funds are what is needed most.

Any support the Congress could give depository institutions on these issues would be welcome.

An important goal of recent financial institution legislation is competitive equity among financial institutions. It has been recognized that such competitive equity is a prerequisite for the efficient operation of financial markets.

EXAMPLE OF INEQUITY

The expansion of specialized thrift institution powers proposed in S. 1720 is a step away from competitive equity. It would provide specialized thrift institutions with some authority, such as the ability to invest in corporate debt securities, not available to commercial banks. More importantly, it would provide specialized thrift institutions with all the powers of a commercial bank without subjecting them to equivalent restrictions. For instance, specialized thrifts would enjoy more liberal branching privileges in many States than commercial banks offering the same financial services.

A flagrant example of the inequity which would result by enactment of the proposals of Chairman Pratt and the administration is the fact that specialized thrifts would continue to be able to exploit an interest-rate differential on certain types of deposits during the phaseout of interest rate ceilings.

The chairman of the Federal Home Loan Bank Board and the leadership of the thrift industry have done everything in their power to frustrate the scheduled phase out of regulation Q as agreed to in last year's legislation. If interest rate ceiling discrimination ever had a justification, it was based on the theory of specialized financial services pitted against full financial services.

In addition to the issue of competitive equality, the expansion of specialized thrift institution powers proposed in S. 1720 raises a serious issue of the safety and soundness of our financial system. An important tool for insuring the safety and soundness of our financial system is the capital requirements imposed on depository institutions.

Banks have higher ratios of capital to assets than specialized thrift institutions of similar size. The level of capital needed to insure the safety and soundness of financial institutions is currently the subject of considerable debate. However, if considerations of safety and soundness require commercial banks to meet certain capital adequacy standards, then other institutions offering the same services should be required to meet the same standards.

Moreover, the mutual form of organization used by most specialized thrift institutions eliminates protections offered by the stock form of organization used by commercial banks. Bank regulatory agencies frequently require commercial banks to raise additional equity to bolster the safety and soundness of the institutions and

support asset growth. This regulatory tool is not available to regulators of mutual institutions.

It should also be recognized that the mutual form of organization in certain instances offers definite competitive advantages. Mutual organizations do not have to face the discipline of raising external equity capital and do not have to pay the dividends need to do so. They either pay regulated rates to their depositors or rates determined in competitive markets that also discipline stockholder's institutions.

The balance of their earnings are retained to support the growth of the institutions or the income of their managers. They are subject to none of the disclosure requirements and marketing requirements needed to attract external equity capital. These requirements are important disciplines to managerial performance.

We believe the Congress should proceed cautiously before creating a system of institutions with full bank powers without bank responsibilities.

EVALUATING BENEFITS OF EXPANSION

In evaluating the long-term costs and benefits of the expansion of specialized thrift institution powers, an alternative to the approach taken in S. 1720 should be considered—namely, allowing conversion to a commercial bank charter. Our association cannot fully commit to support this option at this time. However, it is an option that would allow for a fair and rational liberalization of the powers restrictions that govern thrift institutions. We are currently involved in a careful exploration of this option will all our policy-making bodies. While this option could create other problems that need additional study, it would insure competitive equity among institutions offering the same services and would prevent the proliferation of bank regulatory agencies.

Some proponents of the expansion of thrift institution powers brush aside considerations of competitive equity, the safety and soundness of the financial system and the structure of regulatory agencies to argue that this legislation should be enacted merely because it will increase earnings of these institutions in the future. Some proponents have even argued that this legislation is needed to deal with their immediate earnings problem.

For reasons described above, immediate expansion of specialized thrift institution powers could lead to any significant improvement in earnings. Moreover, several important steps have already been taken to deal with the long run problem.

Thus, expansion of specialized thrift institution powers, such as included in S. 1720, should not be considered in a crisis atmosphere. Legislative action on this portion of S. 1720 should be postponed pending further analysis of the issues raised above—particularly consideration of the option to qualify for and convert to a national bank charter.

In summary, title 1, parts A and B, of S. 1720, Mr. Chairman, are very controversial—so controversial that, if unchanged, they may arouse opposition from homebuilders, realtors, and large segments of the banking community. It would be most unfortunate if these controversial proposals were to result in defeat or delay of the entire bill.

Most of the other provisions of S. 1720 propose legislation which is needed in the public interest and which should be enacted as soon as possible. I have particularly in mind the following issues:

One, emergency powers contained in title 1, parts D and E, and in Section 501;

Two, underwriting revenue bonds contained in section 301, as well as in S. 1427;

Three, mutual fund authority contained in section 301, as well as in S. 1427;

Four, usury provisions contained in title IV, as well as in S. 1406;

Five, due-on-Sale provisions contained in title I, part C;

Six FIRA Amendments contained in sections 221-232; and

Seven, other provisions endorsed in my more complete statement—please refer to the attached summary of our positions on provisions in S. 1720.

We would be very disappointed, Mr. Chairman, if these issue and the other bills you have sponsored were held hostages to parts A and B of title I because a consensus of affected groups cannot be achieved in the short run.

We will work with the committee and other groups to develop such a consensus regarding the future of thrift institutions. But if this consensus does not develop quickly, we urge the committee to act favorably on the issued identified above.

Thank you, Mr. Chairman. And in response to you earlier request for comments on S. 1686. We submit that with our prepared statement.

[Complete presentation of the American Bankers Association follows:]

TESTIMONY

OF

LLEWELLYN JENKINS

on behalf of

THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman, and members of the Committee, I am Llewellyn Jenkins, President of the American Bankers Association (ABA) and Vice Chairman of the Board of Manufacturers Hanover Trust Company of New York City. I am accompanied by Lee E. Gunderson, immediate past President of the ABA and now chairman of the ABA Council, and President of the Bank of Osceola, Wisconsin.

Our Association's membership includes over 90 percent of the more than 14,500 full service banks in the United States. While our members range in size from the very smallest to the very largest banks, approximately 90 percent of them have assets of less than \$100 million.

Mr. Chairman. S. 1720 is a very challenging bill. It offers the Congress and all members of the financial community an opportunity and an obligation to find legislative solutions to problems posed by the new realities of the marketplace for financial services. This is my first appearance in a Congressional hearing in my capacity as President of the ABA, but I assure you that I speak for a consensus of ABA bankers - both large and small. My stewardship is being tested sooner than I had expected.

Mr. Chairman, there has been very little time since the introduction of S. 1720 to analyze and study the specific text of the bill. Most of the major public policy issues addressed by the bill, however, are not new to this Committee or to the ABA. Consequently, my statement today will try to identify these major policy issues, express the position and recommendations of the ABA with respect to these issues, and suggest related issues which are not addressed in S. 1720.

Before commenting on S. 1720, Mr. Chairman, I call to the attention of the Committee the testimony given by Lee Gunderson on May 6, 1981 (printed

by this Committee in recent weeks), which testimony covers many of the issues addressed in S. 1720. Also, Mr. Chairman, the ABA is now at work preparing a detailed critique and commentary on the specific provisions of S. 1720, and I request permission to submit a supplementary statement for inclusion in the Record prior to the closing of these hearings.

With respect to S. 1721, the bill proposing consolidation of the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Administration's Share Insurance Fund, the American Bankers Association cannot support the bill at this time. Similar proposals were made in 1963 (H.R. 729) and in 1972 (Hunt Commission), and on both occasions the ABA did not agree that consolidation was needed or would be good public policy. We realize that conditions have changed since 1972, and further changes in the financial environment are occurring daily. We respectfully request, however, that Committee action on S. 1721 be deferred until there has been additional opportunity to thoroughly consider the need for any ramifications of this proposed consolidation. Bankers are concerned about the impact that the consolidation might have on the current FDIC fund created by assessments on banks. More data are needed and justification must be established before this proposal is acted upon.

My statement today will comment on policy issues in the order that they are presented in S. 1720. The first of these issues is perhaps the most difficult - Parts A and B of Title I.

DEPOSITORY INSTITUTIONS RESTRUCTURING
- Title I - Parts A and B

Many of the proposals contained in S. 1720 are designed to deal with the earnings problems of specialized thrift institutions. In the first six

months of 1981, 70% of the insured savings and loan associations in the country lost money with a combined net loss of \$1.5 billion. Mutual savings bank losses in the same period were about \$480 million. These losses resulted from a combination of large, unforeseen increases in market interest rates and the mismatch between the maturity of specialized thrift institution assets and the maturity of their liabilities. Specialized thrifts hold primarily long term, fixed-rate assets funded with short maturity liabilities. As market interest rates rise, their interest expense increases without a comparable increase in interest income.

There is both a short-run and a long-run aspect to this problem. The immediate, short-run problem is that many specialized thrifts could sustain losses in the near term large enough to exhaust their capital and lead to insolvency. This immediate earnings problem stems from the fact that specialized thrift institutions have low yielding mortgages on their books which they are funding with high cost deposits. Many banks have the same problem. The long-run problem is that specialized thrifts will continue to be vulnerable to similar earnings declines in the future unless something is done to bring about a closer match between the effective maturity of their assets and the maturity of their liabilities. We believe that any satisfactory solution to the problem must address both these short-run and long-run aspects.

Important steps have already been taken in dealing with both the short-run and long-run aspects of the specialized thrift problem. Some of these steps are described in an attachment to our testimony. (See "Recent Government Actions to Help Specialized Thrift Institutions" in Attachment No. 1.) However, we believe that additional steps are needed. In particular, we feel that temporary liberalization of existing rules to

As market rates began to rise in the first half of the 1960's and economic growth resulted in increased loan demand, bank liquidity began to decrease, deposits became a desirable source of funds for banks, and competition among banks and specialized thrifts began to intensify. By 1966, the specialized thrift industry faced a significant slow down in deposit inflows. Placing heavy emphasis on competition from commercial bank CDs as the cause of their difficulties, specialized thrifts and the home builders went to Congress for relief. The result was the Interest Rate Control Act of 1966 which authorized the Federal Home Loan Bank Board to place ceiling rates on S&L deposits. While the differential in favor of thrifts was not mandated by the law, the legislative history made it clear that it was the intent of Congress that specialized thrifts be given an advantage in the competition for consumer deposits. The wording of the act made the setting of rate ceilings on specialized thrifts discretionary. Apparently, the intent was to apply the ceilings as a counter cyclical device when the regulators deemed it necessary to prevent excessive rate competition between banks and specialized thrifts. Rate ceilings thus took on a new complexion; they became a tool of selective credit allocation designed to prop up a sagging mortgage market. In short, the Interest Rate Control Act was intended to insulate the home building industry from cyclical instability by protecting specialized thrift deposits from bank competition.

Experience since 1966 has clearly shown that legislative attempts to protect specialized thrifts and the home building industry through enforced specialization and interest rate ceilings have met with little success. The strong artificial inducements to place a high percentage of their assets in fixed rate home mortgages makes the risk of interest rate fluctuations

scenario of rising market interest rates putting pressure on the earnings of specialized thrift institutions has been played out on no less than six occasions since 1960. It is perhaps useful to trace the history of the specialized thrift problem before dealing with the specific proposals in S. 1720.

Essentially the problems stem from government attempts to allocate credit to support the residential mortgage market. In 1933, Congress established the Federal Home Loan Bank System to charter Federal savings and loan associations. Asset restrictions placed on S&Ls require that they hold the bulk of their portfolios in home mortgages. Specialized thrift institutions were not placed under the deposit rate ceilings which were imposed on banks. Indeed, deposit rate ceilings were originally intended to prevent what was alleged to be destructive competition among banks; competition among specialized thrifts and banks was not a consideration.

From the depression until the late 1950's there was little competition among banks and specialized thrifts for consumer deposits. Low market interest rates and high bank liquidity -- particularly after banks acquired huge government securities portfolios in the war time deficit years -- made it unnecessary for banks to pursue deposits as a source of loanable funds. Specialized thrift institutions generally offered higher rates of return on deposit instruments -- sometimes as much as 2% higher -- than commercial banks paid. The result was that S&L deposits grew much faster than time and savings deposits at commercial banks. In 1935, S&Ls held \$4.3 billion in total deposits while commercial banks held \$12.5 billion in total time and savings deposits; by 1960, these figures had increased to \$62.1 billion for S&Ls and \$66.8 billion for commercial banks. Over the same period deposits at mutual savings banks increased from \$9.9 billion to \$36.3 billion. 1/

1/ Mutual Savings Bank Fact Book

As market rates began to rise in the first half of the 1960's and economic growth resulted in increased loan demand, bank liquidity began to decrease, deposits became a desirable source of funds for banks, and competition among banks and specialized thrifts began to intensify. By 1966, the specialized thrift industry faced a significant slow down in deposit inflows. Placing heavy emphasis on competition from commercial bank CDs as the cause of their difficulties, specialized thrifts and the home builders went to Congress for relief. The result was the Interest Rate Control Act of 1966 which authorized the Federal Home Loan Bank Board to place ceiling rates on S&L deposits. While the differential in favor of thrifts was not mandated by the law, the legislative history made it clear that it was the intent of Congress that specialized thrifts be given an advantage in the competition for consumer deposits. The wording of the act made the setting of rate ceilings on specialized thrifts discretionary. Apparently, the intent was to apply the ceilings as a counter cyclical device when the regulators deemed it necessary to prevent excessive rate competition between banks and specialized thrifts. Rate ceilings thus took on a new complexion; they became a tool of selective credit allocation designed to prop up a sagging mortgage market. In short, the Interest Rate Control Act was intended to insulate the home building industry from cyclical instability by protecting specialized thrift deposits from bank competition.

Experience since 1966 has clearly shown that legislative attempts to protect specialized thrifts and the home building industry through enforced specialization and interest rate ceilings have met with little success. The strong artificial inducements to place a high percentage of their assets in fixed rate home mortgages makes the risk of interest rate fluctuations

higher for specialized thrifts than for banks, and aggravates the thrifts' borrowing short and lending long problem. In effect, the attempt to insure mortgage availability by creating specialized institutions investing almost exclusively in fixed rate loans means that those institutions bear an undue amount of interest rate risk. The supposed protection afforded by interest rate ceilings has been unsuccessful. The result of rate ceilings has been periodic bouts of disintermediation for both banks and specialized thrifts, resulting in problems for both kinds of institutions.

In June 1978, the Federal regulators authorized specialized thrifts and banks to offer money market certificates (MMC) with a \$10,000 minimum denomination, six month maturity, and a rate tied to the six month treasury bill. By August 1981, there were some \$486.7 billion outstanding in MMCs. The MMC has undoubtedly kept banks and specialized thrifts from experiencing a disastrous run off of funds to unregulated alternatives like money market funds of securities companies. While helping depository institutions to retain deposits, however, MMCs have significantly raised the cost of funds.

In the Depository Institutions Deregulation and Monetary Control Act of 1980, Congress recognized the failure of ceilings on deposit rates to achieve stability in specialized thrift deposits. The Act provided for the phase-out of deposit rate controls by 1986, while at the same time granting new asset and liability powers to specialized thrifts. Meanwhile, the market continues to innovate around regulatory restrictions with such devices as loophole MMCs, retail repos, and links between NOW accounts, checking accounts, and money market funds. The rapid drop in the percentage of time and savings deposits subject to inflexible Federal rate ceilings over the past decade is testimony to the fact that a significant amount of deregulation has already taken place on the deposit side. The increased

flexibility on the asset side in the form of the increased lending powers granted in P.L. 96-221, and the use of variable rate mortgage instruments recently authorized by the FHLBB, have not yet been fully implemented. This has resulted in a short-run earnings squeeze on the specialized thrift industry.

CURRENT CONDITION OF SPECIALIZED THRIFT INSTITUTIONS

The short-run specialized thrift industry problem has become particularly acute during 1981. As an example, the net worth of savings and loans has decreased since the beginning of the year. At the end of 1980, the aggregate net worth of the savings and loan industry was \$33.1 billion. At the end of August 1981 it was \$29.7 billion, a decline of \$3.7 billion since the beginning of the year. The general reserve accounts of mutual savings banks declined from a peak of \$13.4 billion in February of 1981 to \$10.8 billion in June, 1981. ^{2/}

A better perspective on the problems of the savings and loan industry is revealed by figures from the December 1980 call reports collected by the Federal Home Loan Bank Board. The calculations can be used to get a more disaggregated view of the savings and loan industry and the problems that it faces in the short run. Mutual savings banks face almost identical problems as savings and loan associations. We are in the process of analyzing data for these institutions, but the analysis is not yet completed. Given their similarity with savings and loan associations, and the fact that many of them are located in states with a history of restrictive usury ceilings and relatively low growth rates, the analysis of these numbers will undoubtedly portray the same picture for these institutions.

^{2/} Federal Home Loan Bank Board Journal, Federal Home Loan Bank Board Annual Report, Wall Street Journal, and Federal Reserve Bulletin

In the last six months of 1980, 1326 institutions out of 4002 members of the FSLIC lost money. These 1326 institutions held 30.8% of the industry assets. Although comparable figures are not available for commercial banks, in the ABA survey of banks using data from December 1980 call reports, 3.9% of the commercial banks lost money.

Tables 1 and 2 (Attachment No. 2) give information on the net worth of savings and loan associations. Table 1 gives the number of associations and table 2 gives the figures as a percent of industry assets. There are 15 institutions that have a negative net worth. This is normally the result of negative net undistributed profits. Out of a total of 4002 associations, there are 347 associations with a net worth below 3%. There are 1630 associations or 40.8% with a net worth to total asset ratio of less than 5%. These institutions hold 43.9% of industry assets. This compares with 219 commercial banks or 1.6% of commercial banks with a ratio of equity capital to total assets of less than 5%. 3/

Savings and loans have also experienced problems of outflows of deposits. In August, the withdrawals of savings exceeded the deposits by \$3.7 billion. However, this does not mean that the liabilities of the savings and loans fell by \$3.7 billion. First, one must add the \$1.9 billion in interest credited on accounts. Counting interest left on deposit, the savings and loan associations' deposits decreased by only \$1.3 billion in August. For 1981, through August, there is still a positive growth of deposits of \$2.4 billion. One also must take into account the other increases in liabilities that do not appear in the deposit figures. Retail repurchase agreements have become very popular and are offered by many associations. This type of instrument is not covered by insurance and is not counted as deposits. It has been estimated by Federal Home Loan Bank

3/ Table 114, 1980 FDIC annual report

Board officials that about 1/3 of the deposit withdrawals have actually remained within the savings and loan system in the form of repurchase agreements. 4/ Because of these factors, the figures are not as grim as they might seem at first glance.

It should be emphasized that the above figures illustrate that the thrift industry is facing a short run earnings squeeze, not a liquidity problem. With the existence of deposit insurance and the ability of the associations to borrow from the Federal Home Loan Bank Board, there is no reason to fear a run on deposits such as occurred during the 1930's. The deposit outflows have also been mitigated by recent actions that allow higher rates to be paid on the small-saver certificates as of August 1. The introduction of the tax free certificate on Oct. 1 gives institutions a means of attracting funds while paying less than the market interest rate of interest. All of the above, as well as the fact that mortgage commitments are still being made, \$3.8 billion in August, emphasize that the savings and loans are not facing a liquidity problem.

The savings and loans are facing an earnings problem, as demonstrated by their decrease in net worth and the many assisted mergers made by the FSLIC this year. This is a short run problem, the solutions of which are contained in Parts D and E of Title I of S. 1720.

The cause of the problem is the high and volatile market interest rates compounded by the structural framework of the specialized thrift industry. The most promising way of dealing with high and volatile interest rates is the economic recovery program formulated by the President. Our Association has been vigorously supporting this program.

4/ Wall Street Journal, 9/25/81, p. 4.

PROPOSED EXPANSION OF THRIFT POWERS

With this background, we would like to discuss one solution to the problem of specialized thrift institutions proposed in S. 1720 — a significant expansion of their powers. Title I of S. 1720 would substantially expand the authority of specialized thrift institutions on both the asset and liability side of the balance sheet. In particular, on the liability side it would allow them to offer demand deposits. On the asset side, it would allow them to invest in a considerably broader range of assets including commercial loans, consumer loans (including inventory and floor plan loans), commercial paper, corporate debt securities, municipal securities, a broader variety of mutual funds (including some funds holding assets in which the thrift could not invest directly), an expanded variety of educational loans, and equipment leasing. This legislation would remove many of the restrictions currently placed on specialized thrift investments in real property loans and allow them to make overdraft loans on any type of transactions account. In addition, S. 1720 would facilitate conversion of specialized thrift institutions from State to Federal charter and from mutual to stock form of organization.

It is important to recognize that this proposed expansion of thrift powers will do nothing in the near term to offset earnings problems. It does nothing about the low-yielding mortgages currently held in thrift portfolios. To utilize many of the additional powers granted in S. 1720, specialized thrifts would have to enter entirely new markets in which they currently have no experience. This would require substantial investments in personnel and customer relationships which will not begin generating profits for some time. The competitive nature of the markets which specialized thrifts would be allowed to enter, and their lack of expertise in these

markets, makes it likely that at least some specialized thrifts will initially incur substantial losses. Thus, expansion of specialized thrift institution powers will involve a period of negative cash flow for the expanding institutions, further exacerbating their immediate earnings problem. Even if it were concluded that expansion of specialized thrift institution powers might reduce the likelihood of a future recurrence of earnings problems, it would be important to postpone expansion of such powers until specialized thrifts are better able to handle the temporary negative cash flow that is likely to result.

Nevertheless, we believe controlled expansion of specialized thrift institution powers could in the long term help solve their problems and deserves further study. A diversification of specialized thrift institution assets and liabilities could allow them to better match the effective maturity of their assets and liabilities and reduce their vulnerability to unforeseen increases in interest rates. However, because expansion of specialized thrift institution powers as proposed in S. 1720 will not immediately help and, in fact, may aggravate their current earnings problem, there is no need to act on this legislation in a crisis atmosphere. The broadened authority to offer variable rate mortgages will allow specialized thrift institutions to share interest rate risks with borrowers. Ability to trade financial futures provides the potential for them to reduce their interest rate risk. Thus, because there is no need to enact an expansion of specialized thrift institution powers in a crisis atmosphere, legislative action should await study of several serious issues relating to the long-run effect of such an expansion of their powers. These include competitive equity among depository institutions, the safety and soundness of the financial system, and the structure of regulatory agencies.

It should also be recognized that an important part of the so-called thrift problem has nothing to do with their competitive position vis-a-vis banks and, hence, will not be changed by altering the laws and regulations that govern the position. I am referring to the competitive problem that all depository institutions have vis-a-vis nondepository institutions. Other parts of S. 1720 address some of the restrictions that have created this problem, and we will comment on these later. However, another important aspect of this problem, a faster and more equitable liberalization of Regulation Q ceilings, can only be resolved by the Depository Institutions Deregulation Committee. A faster elimination of longer term ceilings affecting consumer certificates of deposit, and a short-term deposit instrument competitive with money market funds are what is needed most. Any support the Congress could give depository institutions on these issues would be welcome.

An important goal of recent financial institution legislation is competitive equity among financial institutions. It has been recognized that such competitive equity is a prerequisite for the efficient operation of financial markets. The expansion of specialized thrift institution powers proposed in S. 1720 is a step away from competitive equity. It would provide specialized thrift institutions with some authority (such as the ability to invest in corporate debt securities) not available to commercial banks. More importantly, it would provide specialized thrift institutions with all the powers of a commercial bank without subjecting them to equivalent restrictions. For instance, specialized thrifts would enjoy more liberal branching privileges in many states than commercial banks offering the same financial services.

A flagrant example of the inequity which would result by enactment of

the proposals of Chairman Pratt and the Administration is the fact that specialized thrifts would continue to be able to exploit an interest rate differential on certain types of deposits during the phase-out of interest rate ceilings. The Chairman of the Federal Home Loan Bank Board and the leadership of the thrift industry have done everything in their power to frustrate the scheduled phase-out of Regulation Q as agreed to in last year's legislation. If interest rate ceiling discrimination ever had a justification it was based on the theory of specialized financial services pitted against full financial services.

Further, no attempt is made to limit the other competitive advantages that would be enjoyed by specialized thrift institutions. In the interest of competitive equity, specialized thrift institutions must not be given all the powers of commercial banks without being subjected to identical constraints.

In addition to the issue of competitive equality, the expansion of specialized thrift institution powers proposed in S. 1720 raises a serious issue of the safety and soundness of our financial system. An important tool for insuring the safety and soundness of our financial system is the capital requirements imposed on depository institutions. Banks have higher ratios of capital to assets than specialized thrift institutions of similar size. The level of capital needed to insure the safety and soundness of financial institutions is currently the subject of considerable debate. However, if considerations of safety and soundness require commercial banks to meet certain capital adequacy standards, then other institutions offering the same services should be required to meet the same standards.

Moreover, the mutual form of organization used by most specialized thrift institutions eliminates protections offered by the stock form of

organization used by commercial banks. Bank regulatory agencies frequently require commercial banks to raise additional equity capital to bolster the safety and soundness of the institutions and support asset growth. This regulatory tool is not available to regulators of mutual institutions.

It should also be recognized that the mutual form of organization, in certain instances, offers definite competitive advantages. Mutual organizations do not have to face the discipline of raising external equity capital, and do not have to pay the dividends needed to do so. They either pay regulated rates to their depositors, or rates determined in competitive markets that also discipline stockholder's institutions. The balance of their earnings are retained to support the growth of the institutions or the income of their managers. They are subject to none of the disclosure requirements and marketing requirements needed to attract external equity capital. These requirements are important disciplines to managerial performance. We believe the Congress should proceed cautiously before creating a system of institutions with full bank powers without bank responsibilities.

A third important issue related to the proposed expansion of thrift institution powers is the effect upon the current structure of regulatory agencies. This expansion would create yet another regulator of "commercial banks." The Federal Home Loan Bank Board would be called upon to examine and supervise activities about which it has no expertise. While we have generally supported regulatory pluralism, the creation of another bank regulatory agency is not a step to be taken lightly. In evaluating the long term costs and benefits of the expansion of specialized thrift institution powers, an alternative to the approach taken in S. 1720 should be considered — namely, allowing conversion to a commercial bank charter. Our

Association cannot fully commit to support this option at this time.

However, it is an option that would allow for a fair and rational liberalization of the powers restrictions that govern thrift institutions. We are currently involved in a careful exploration of this option with all of our policymaking bodies. While this option could create other problems that need additional study, it does insure competitive equity among institutions offering the same services and prevents the proliferation of bank regulatory agencies.

It should also be recognized that Parts A and B of Title 1 of S. 1720 are a confession of failure of governmental policy. We believe policymakers are proposing to let specialized thrift institutions assume commercial bank powers because they have finally realized that attempts to prop up the housing market by selective credit allocation through specialized thrift institutions will not work. Policymakers should also face up to the regulatory implications of this confession of failure. Since its inception, the Federal Home Loan Bank Board has shown a more favorable attitude toward the institutions it regulates than bank regulators have toward banks. Some bankers usually put it more bluntly. Specialized thrift institutions have a "cheerleader" in Washington; banks have a regulator. The latest example of this cheerleader vs. regulator dichotomy occurred when the Federal Home Loan Bank Board tried to promulgate regulations which would allow their members to offer NOW accounts to certain types of municipal governments in clear violation of congressional intent. Bank regulators proposed regulations which clearly would have left banks at a competitive disadvantage. Fortunately, we were able to correct this problem through recourse to the courts. In other instances we have not been so fortunate. In any case, recognition that selective credit allocation through

specialized thrift institutions will not work calls for a change in regulatory philosophy as well. The Homeowners Loan Act should be amended to make it clear that the Federal Home Loan Bank Board is a regulator of depository institutions for the benefit of their depositors, not an advocate whose role is to protect those institutions from competition.

Some proponents of the expansion of specialized thrift institution powers brush aside considerations of competitive equity, the safety and soundness of the financial system, and the structure of regulatory agencies to argue that this legislation should be enacted merely because it will increase earnings of these institutions in the future. Some proponents have even argued that this legislation is needed to deal with their immediate earnings problem.

In summary, for reasons described above, immediate expansion of specialized thrift institution powers would actually aggravate the short-run problem. It will take years before expansion of specialized thrift institution powers could lead to any significant improvement in earnings. Moreover, several important steps have already been taken to deal with the long-run problem. Thus, expansion of specialized thrift institution powers such as included in S. 1720, should not be considered in a crisis atmosphere. Legislative action on this portion of S. 1720 should be postponed pending further analysis of the issues raised above — particularly consideration of the option to qualify for and convert to a national bank charter.

PREEMPTION OF DUE ON SALE PROHIBITION - Title I, Part C

ABA supports enactment of Sec. 141 of S. 1720, which permits all depository institutions and HUD-approved lenders to enforce due-on-sale

clauses as a matter of federal law by reason of the doctrine of federal preemption. In our judgment, the most basic element of any legislative attempt to help thrift institutions to survive in this period of high interest rates, must permit the inclusion of due-on-sale clauses in mortgage contracts and their enforcement without regard to contrary provisions of state law.

In the enactment of the Housing and Community Development Act of 1980 (P.L. 96-399), Congress directed the Secretary of Housing and Urban Development to conduct a study of the effects of due-on-sale clauses. (House Conference No. 96-1420, September 26, 1980.) The HUD study, which has been publicly released, concludes that the enforcement of due-on-sale is not violative of any public policy and is an important device for a real estate lender to perform its intermediary function. The report states:

"Our conclusion is that there is no compelling reason to request that mortgages be assumable, that is, to prohibit due-on-sale clauses. To do so would impose additional regulations on the housing finance system, limiting the choices of both borrowers and lenders, and slowing the pace of the needed reform of depository institutions embodied in the Depository Institutions Deregulation and Monetary Control Act of 1980. This would lead to higher interest rates on fixed rate mortgages or to their complete disappearance. Furthermore, retroactively voiding due-on-sale clauses on existing mortgages would perpetuate the losses that lenders are taking on their mortgage holdings. Given the already troubled state of the thrift industry, such a move would increase the pressure for industry wide government assistance..." [An Economic Analysis of Due-On-Sale Clauses, Office of Policy Development and Research, U.S. Department of Housing and Urban Development, April, 1981, p. 2.

The interest rate adjustment purposes of the due-on-sale clauses may be supplemented by rate sensitive alternative mortgage instruments. But the adjustable rate feature of mortgages with due-on-sale provisions will continue to be a critical lending device to adjust the yield of a loan portfolio. Regardless of the availability of adjustable rate mortgages, it will take years for long-term lenders to shift their portfolios into rate

sensitive instruments. Notwithstanding the asset-side flexibility provided by adjustable rate mortgages, banks and thrifts alike must have the asset flexibility offered by the due-on-sale clause in order to cope with the adjustment in deposit liabilities.

EMERGENCY POWERS FOR FEDERAL FINANCIAL REGULATORS -
Title I, Parts D & E

Parts D and E of Title I provide expanded authorities for the Federal agencies to confront immediately the problems of troubled depository institutions. Our Association believes the regulatory agencies should be provided this "safety net" mechanism subject to the following conditions:

1. The significant exceptions to current law provided for in the legislation must be temporary, and terminated in no more than two years.
2. The financial assistance authority granted to both the FDIC and FSLIC must be identical in its applicability to depository institutions under their jurisdictions.
3. The emergency merger and acquisition authority granted to the agencies must be fully comparable and patterned after that proposed for the FDIC. However, all possibilities for intrastate mergers and acquisitions must be exhausted prior to utilization of provisions for interstate mergers and acquisitions.

With respect to the rules concerning financial assistance, it appears that the authority granted the FSLIC under this proposed legislation would exceed the authority given the FDIC. For example, a below-market interest rate on an FDIC assistance loan would be counted as an insurance expense that would have to be deducted in calculating the net assessment income credit available to insured commercial and mutual savings banks. By

contrast, this kind of transaction currently results in a reduction of the FDIC's investment portfolio yield. We believe this proposed change should also apply to FSLIC transactions. This could be done by amending Section 164. In addition, the ABA questions Section 156 which would allow each Federal Home Loan Bank to waive existing requirements and pay dividends out of undivided profits if the Federal Home Loan Bank Board determines that severe financial conditions exist threatening the stability of member institutions.

As for acquisition and merger authority, Sections 151 and 152 of Part D would allow the FSLIC to approve a merger or a transfer of assets and liabilities between two FSLIC-insured institutions, regardless of where they are located, or between an insured institution and any other company. Section 151 requires the FSLIC to give paramount consideration to minimizing the financial assistance provided by the Corporation. First preference would go to institutions of the same type within the same state; second to institutions of the same type in different states; third to institutions of different types in the same state; and fourth to different types in different states.

Under Section 165 of Part E, the FDIC, as a receiver of a large failed FDIC-insured bank with assets of at least 0.12 percent of total domestic assets, (about \$2 billion), would have the authority to arrange the sale of the assets of the bank to an out-of-state institution. The sale and assumption process would give first priority to in-state financial institutions and second priority to institutions in adjacent states, before sale to subsidiaries of other out-of-state institutions is allowed. The ABA was disappointed that the Federal Home Loan Bank did not pursue this logical process when it recently approved the merger of troubled associations in New

York and Florida into Citizens Savings and Loan Association of San Francisco.

The ABA believes the merger and acquisition authority for all the agencies should be comparable to and patterned after the FDIC proposal. In addition, we believe that all possibilities for intrastate mergers and acquisitions should be exhausted prior to use of any interstate options, and that interstate possibilities should focus on contiguous states or regional states before being considered on a nationwide basis. We believe that this position does not undermine our support for the principles of the McFadden Act and/or the Douglas Amendment to the Bank Holding Company Act. If the acquisition of a failing thrift institution across state lines by a bank holding company is necessary to preserve depositors' funds or public confidence in the financial system, we believe the branching laws applied to banks in the state of the acquired institution should apply to the acquired institution.

The ABA regrets the emergency circumstances which apparently make it necessary to legislate changes in public policy permitting interstate mergers or interstate acquisitions of financial institutions even on a temporary basis.

In legislating these emergency and temporary changes, we urge you to require that all possibilities for intrastate mergers or acquisitions be exhausted before interstate solutions are approved. Section 151 of Part D should be amended accordingly, including preference for contiguous states when an intrastate solution is not possible.

SECONDARY MARKET PURCHASE AUTHORITY - Sec. 173

Many banks and most thrift institutions have a large portion of their

assets concentrated in long-term fixed-rate residential mortgages, while their liabilities are concentrated in shorter-term deposits. The rates on many mortgages acquired in past periods are much lower than both short- and long-term interest rates prevailing in the market. As a result, net earnings to these institutions have been held down, and the ability of these institutions to attract or retain funds has been restricted.

Our Association supports all efforts to relieve the drag of low-rate mortgages on earnings so long as the programs: (1) are available on an equitable basis to all institutions that had acquired long-term residential mortgage assets in past periods when future levels of market interest rates were under estimated; and (2) involve no cost to the Treasury or to the public resulting in additional borrowings by the Treasury or by Federally related agencies.

ABA supports Sec. 173(a) authorizing the Federal Home Loan Mortgage Corporation to purchase mortgage loans from the Federal Deposit Insurance Corporation. The amendment would assist the FDIC in the orderly management of its portfolio of acquired mortgage loans, and facilitate the liquidation of the mortgage assets of national banks under FDIC control. The amendment would also equate the Federal Home Loan Mortgage Corporation's purchase authority from the FDIC with that from the FSLIC, and reflect the growing use of the Mortgage Corporation's programs by FDIC-insured institutions.

We also support subsections (b) and (c), with a qualification, to remove the limitation on the number of mortgages more than one year old that the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Corporation could purchase. Both of these organizations have announced programs to purchase low-rate mortgages, thus necessitating the removal of the percentage limitation for the purchase of older loans. These programs

should benefit eligible lenders with new earning opportunities by providing a means to convert low-yielding mortgages into securities which can be used as collateral for a variety of purposes.

Our support for subsection (b), regarding the Mortgage Corporation, is contingent on clarifying that all depository institutions will be able to sell mortgages under the SWAP program on an equal fee basis.

A long standing request of commercial banks is that they be charged the same fees for the sale of mortgages to the Corporation as are charged the savings and loan associations that sell mortgages. Under the Mortgage Corporation's present rules, commercial banks and other mortgage sellers are charged a sales fee of one-half of 1%, while institutions that are members of the Home Loan Bank system pay nothing. While the Corporation has drafted legislation entitled the "Federal Home Loan Mortgage Corporation Charter Act" to address this long-term situation equitably, which our Association supports, we feel that the Congress should address a part of the problem now by indicating that all institutions afflicted by the problem of low-rate mortgages should enjoy equal access to both FNMA and the Mortgage Corporation on a non-discriminatory user fee basis.

NATIONAL BANK LENDING LIMITS - Sec. 201

Section 201 of the bill would increase the single borrower limit of the National Bank Act from its present level of ten percent of a national bank's capital and surplus to fifteen percent. It would authorize a national bank to lend an additional ten percent of its capital and surplus to any individual borrower whose loans were fully secured by readily marketable collateral. And it would consolidate the present fourteen exceptions to the single borrower limit into seven.

Our Association has long believed that the ten percent single borrower limit of the National Bank Act is overdue for revision. This basic limit has been unchanged since the enactment of the National Bank Act in 1864 (in fact, the provision originated in the National Currency Act of 1863). Although modeled on the provisions of the so-called "free banking statutes" then in force in many of the states, it is now below the lending limits of state-chartered banks in the vast majority of states. Most state lending limits also provide, as Section 201 does, both higher single borrower limit~~s~~ for unsecured loans and separate limits for loans fully secured by certain types of real and personal property.

We support Section 201. Nevertheless, although we believe this provision as written will be of considerable assistance to smaller national banks in meeting many of the credit needs of their local communities from their own resources, we believe that a better way of addressing single borrower limits would be an amendment to this provision to authorize the Comptroller of the Currency to establish single borrower limits for national banks. Language similar to that contained in Section 202 below would increase the flexibility of statutory single borrower requirements and permit banking's regulators to respond more quickly and effectively to changing economic conditions.

NATIONAL BANK BORROWING LIMITS - Sec. 202

Section 82 of the National Bank Act presently limits the ability of a national bank to borrow money by restricting bank indebtedness to 100 percent of its capital accounts and 50 percent of its unimpaired surplus. Written at a time when banks were expected to conduct virtually all of their operations on their equity accounts or their customers' deposits, it has had

to be amended with twelve exceptions since its enactment. It now remains, particularly in inflationary times such as these, a very significant hindrance to national bank operations.

Section 202 would provide discretion to the Comptroller of the Currency in determining aggregate indebtedness limits of national banks. It would authorize the Comptroller to limit national bank indebtedness both by type of debt and in the aggregate. Because we believe that the flexibility inherent in this provision will allow banks and their regulators to better respond to changing economic circumstances, our Association supports Section 202.

BANK REAL ESTATE LENDING POWERS - Sec. 203

A longstanding priority of the ABA has been to have the Congress review and revise the restrictions imposed on national bank real estate lending, which are contained in 12 U.S.C. 371. The last date of statutory change in this section was 1974. We welcome the consideration of this matter in Sec. 203 of S. 1720. Banks, as major providers of real estate finance, have attempted to respond to their customers' needs for mortgage credit, but frequently we have found that the restraints of 12 U.S.C. 371 precludes us from being as flexible or innovative as our competitors.

The section-by-section analysis of this provision indicates that the purpose of section 203 is "... to simplify the statutory framework by which national banks are authorized to engage in real estate activities. The revised provision deletes existing rigid statutory standards and authorizes the Comptroller to promulgate regulatory standards affecting such conduct." This purpose is fully in concert with the legislative goal of our Association.

However, we must point out that there is an inconsistency between the stated goal and the proposed statutory language of Sec. 203, with the latter being unduly complex and restrictive. While the proposed section is certainly an improvement over the present loan-to-value ratios of the present law, we would prefer that banks have the same investment authority as is proposed for S & Ls in Sec. 122 of the bill. Sec. 122 is a much better model of a statutory means to accomplish the goal of deleting existing rigid statutory standards and permitting the supervisory regulator maximum flexibility in issuing regulations for a depository institution to meet the demand for mortgage and real estate credit.

A matter of growing concern to banks and bank affiliated mortgage banking companies is the increasing competitive advantages of S&L service corporations. While banks and S&Ls are not presently permitted to engage in joint real estate ventures and other forms of equity participation, S&Ls are now authorized to invest up to 3% of their assets in service corporations (which under Sec. 130(4) (B) would be increased to 5%). Such corporations are permitted to make wide ranging real estate investments as equity investors and to participate in a broad array of financial activities, including the sale of all types of insurance.

ABA believes that the service corporation concept, successfully employed in the S&L industry, should be adopted for use by commercial banks. We believe that this concept could be particularly beneficial to community banks, which as a group do a significant amount of real estate lending, but do not, as individual institutions, originate a large enough volume of mortgage loans to participate in secondary mortgage market activities on an ongoing basis. Banks in their relationship with builders and developers are increasingly being asked to do joint ventures in real estate development as

S&L service corporations do. To meet this market demand, both the Bank Service Corporation act and Section 29 of the National Bank Act need to be amended to provide banks all the tools necessary to meet the real estate market of the 1980's.

Our Association believes that demographic and economic factors will cause the 1980's to be among the periods with the most explosive growth in demand for housing in the nation's history. Without the new authority contained in this legislation, banks and savings institutions will have significant handicaps in serving the housing market. But even with this authority, depository institutions will be hampered in meeting all of the needs of their customers, and, more significantly in doing so at reasonable cost, without the ability to engage in real estate development and to take equity participations in real estate. ABA would urge the Committee to amend Section 29 of the National Bank Act to authorize bank ownership of an interest in real estate for development or investment purposes.

BANKERS' ACCEPTANCES - Sec. 209

The American Bankers Association supports this provision that would amend Section 13 of the Federal Reserve Act by permitting U.S. member banks to increase the eligible acceptance limit to twice the bank's paid-up and unimpaired capital stock and surplus; and, with the permission of the Federal Reserve Board, increase the limit to three times such capital stock and surplus. Eligible acceptances would not be counted against this limitation to the extent that they (i) arise from the international shipment of goods, and another bank, Edge Act Corporation, or Agreement Corporation is liable to reimburse the member bank or (ii) are participated in by another bank, Edge Act Corporation, or Agreement Corporation. The provision

would also eliminate the requirement that shipping documents be attached to acceptances arising from the domestic shipment of goods.

A bankers acceptance represents a bank's agreement, or "acceptance", to honor its customer's order to pay a specific sum of money at a set future date. Bankers acceptances are predominantly used to finance international trade. Because acceptances are generally of short maturity (less than 180 days) and secured by the underlying goods, they provide a very safe form of financing.

At the present time, many U.S. banks are unable to provide additional eligible acceptance financing because they have reached their aggregate limitation of 100% of capital and surplus, set by law over 65 years ago. The proposed amendment to existing law would liberalize the current limitation on eligible bankers acceptances by generally adopting the structure already utilized by the Federal Reserve Board for regulating the acceptances of Edge Corporations. The increase in the ceilings would create sufficient flexibility for United States banks to meet the demands of United States exporters and other customers. At the same time, the bill would continue the conservative policy of maintaining a defined limit on unsecured acceptances.

The proposed liberalization of the 1915 acceptance limitations would have five principal benefits:

- 1) Enhance the ability of regulated member banks to compete with unregulated credit sources,
- 2) increase acceptance financing available for smaller U.S. exporters and agricultural concerns,
- 3) non-speculative types of financing would be encouraged,
- 4) contribute significantly to the United States' position as a center

for international trade and finance, and

5) contribute to a reduction in our trade deficit.

As we have highlighted, the proposed changes to Section 13 of the Federal Reserve Act would enable United States banks to provide additional financing for United States exporters, reduce the cost of United States imports and strengthen the position of the United States as a trade and financial center — all without any adverse impact on individual banks, the banking community, or the public. The American Bankers Association supports this provision of S. 1720. Additionally, since many provisions contained in S. 1720 address competitive equity in the financial marketplace and since currently, U.S. branches and agencies of foreign banks are not subject to any acceptance limitations, we would recommend that U.S. branches and agencies of foreign banks be subject to the same acceptance limitations that apply to U.S. member banks. (For additional justification please see Attachment No. 3.)

LIMITATION ON FINANCIAL TRANSACTIONS BETWEEN BANKS
AND AFFILIATED COMPANIES - Sec. 210

Section 210 would amend section 23A of the Federal Reserve Act to revise the restrictions on transactions between banks and their affiliates.

Section 23A of the Federal Reserve Act was enacted as part of the Banking Act of 1933, and since then has been amended on a number of occasions. The statute attempts to protect banks in transactions with affiliates in two ways. First, it limits a bank's transactions with any single affiliate to no more than 10% of the bank's capital and surplus, and with all affiliates combined to no more than 20%. Second, the statute requires that all bank loans or other extensions of credit to affiliates be fully secured.

Over the past several years there has been growing agitation for amending Section 23A. The statute is widely acknowledged to be poorly drafted and haphazardly organized. These features have made it difficult to comply with and to enforce. In addition, when applied to intercorporate dealings between banks and their affiliates in today's environment, the statutes is unduly restrictive and we believe should be changed.

The proposed language of Section 210, which was drafted by the Federal Reserve Board after lengthy study, is more logically organized than the present law and clarifies and simplifies what is today a very complicated statute. In addition, it liberalizes certain out of date restrictions currently imposed by Section 23A, while maintaining the statutes original purpose of preventing the misuse of a bank's resources stemming from non-arms-length financial transactions with companies with which the bank is affiliated. Our Association supports the objectives of Section 210 of Title II of S. 1710. Our Association believes, however, that one change should be made in Section 210. As proposed, the Board's language would eliminate a current exemption in 23A for purchases of loans on a non-recourse basis from an affiliated bank. Elimination of this exemption could have a profound effect on the efficiencies of institutions affiliated in two different ways. First, it would impact on bank holding company subsidiary banks which are less than 80% owned by the parent holding company. Secondly, it would impact on so-called "chain banking" systems, due to the expansion of the definition of "affiliate", and would cover a larger number of those organizations.

While one might agree or disagree with the basic policy judgments made by the Board in eliminating this exemption, these judgements were originally made prior to the enactment of the Financial Institutions Regulatory Act of

1978 (FIRA).

This Act (FIRA) gives the Federal bank regulatory agencies substantially improved supervisory and enforcement tools and may well obviate many of the concerns that led the Board to its policy decision. Further, some of the principles in that Act, as well as principles set forth in the proposed Section 23A legislation, might well provide a method of control which would meet the Board's supervisory concerns without interfering with the benefits which the Board itself sees in the transactions. First, the change in the Bank Control Act portion of FIRA provides the additional layer of Federal regulation which the Board finds lacking with respect to the chain bank situation by requiring approval of changes in control. Furthermore, FIRA substantially amends the Financial Institutions Supervisory Act and provides markedly increased enforcement authority against officers of banks. Bank regulatory authorities may now institute supervisory actions when it appears that the bank "... has suffered or will probably suffer substantial financial loss or other damage."

The foregoing provisions certainly give the Board and the other Federal bank regulatory agencies ample opportunity to reach those cases in which transfers of loans from one bank affiliate to another result in financial disadvantage to one or the other. Furthermore, recent experience with reporting requirements relating to "insider transactions" makes it clear that reporting and recordkeeping requirements can be imposed under current law which are adequate to enable the agency to police the transactions and take such actions as may be necessary.

In addition, the proposed Section 23A legislation prohibits transfers at less than fair market value, even among affiliates who are exempted by

virtue of being more than 80% owned by a common holding company. Such a provision, coupled with the civil penalty provisions of FIRA which can amount to \$1000 per day for each day that a violation of Section 23A continues would seem to provide a more than adequate deterrent to any abuses in connection with such transactions. Thus, the public benefits which the Board sees arising from sales of loans between related institutions can be readily realized without any substantial likelihood that the potential abuses which concern the Board will occur.

In view of the foregoing, it appears that Congress should take into consideration its action in enacting FIRA when deliberating the advisability of this portion of the Board's recommended legislation. To fail to do so would be to seriously overregulate in this area without any demonstrated abuses. Such overregulation would interfere with the efficiency of financial institutions and their ability to provide needed financing to all sectors of the economy. The public would be harmed, not benefitted, by such action. We therefore recommend that Section 210 be amended to retain the existing exemption in Section 23A for purchases of loans on a non-recourse basis from an affiliated bank.

EXEMPTION FROM RESERVE REQUIREMENTS - Sec. 211

The hearings leading to the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221) generated a great deal of debate over the necessity for mandatory reserve requirements, the form of such reserves, and the types of deposits on which reserves should be imposed. The result was a public policy decision that reserve requirements are necessary for monetary policy and should be imposed on transactions accounts and non-personal time deposits at all depository

institutions, including non-member banks, savings and loans, mutual savings banks, and credit unions as well as Fed member banks.

ABA supported the concept of uniform universal reserve requirements as included in P.L. 96-221. ABA's position, developed by our consensus process which includes input from a wide cross section of the banking industry, was predicated on the participation of all financial intermediaries of all sizes. It should be pointed out that it was the Community Bankers Division of our Association, those smaller institutions that would benefit most by exemptions from reserve requirements, that most strongly objected to a reserve requirement burden that was distributed inequitably among institutions.

Reserve requirements are a tax levied on depository institutions to facilitate the conduct of monetary policy. One of the essential principles of taxation is that the tax should be fairly applied. Congress recognized and acted upon this principle in the Monetary Control Act of 1980 by requiring that all depository institutions exercising similar transaction account authority maintain similar reserves. At the same time, Congress recognized the need for flexibility during the transaction period. Because of the administrative complexity of supervising reserves for the 20,000 institutions with less than \$5 million in deposits, the Federal Reserve Board has exercised its administrative discretion by twice delaying the implementation of reserves on these institutions. Our Association has not objected to the Board's action because we understand that smaller depository institutions, as well as the Fed, need time to adjust to new responsibilities as major as reserve requirements.

The legislation before the Committee today, however, would permanently exempt depository institutions with less than \$5 million in deposits from

required reserves. Our Association strenuously objects to this proposal. If reserve requirements matter for monetary policy — and P.L. 96-221 said that they do — then they must be applied to all institutions offering transactions accounts. Indeed, it should be pointed out that Chairman Volcker has recently testified that he believes the Fed should be given authority to extend reserve requirements to money market funds accessible by checks to improve monetary control. The proposal to exempt certain small depository institutions from reserve requirements flies in the face of this testimony and the record established in the hearings culminating in the Monetary Control Act of 1980. Money held at these institutions has the same purchasing power as money held at large institutions. Excess amounts of it have the same inflationary potential. .

In addition to the question of implementation of monetary policy is the question of competitive equity. This legislation would create an unbalanced situation in which depository institutions differing in size facing each other in a competitive situation would be working under different ground rules. While one institution would be required to hold a portion of its deposits in non-earning reserves, the other would be free to put all of its deposits to work for its shareholders. We also note that many of the institutions which would be freed of reserve requirements — credit unions — are already free of Federal, state and local taxation, state usury ceilings, and many of the regulatory constraints under which their commercial bank, savings and loan, and mutual savings bank competitors must operate.

The American Bankers Association strongly opposes this section of the bill. We believe that equity demands like treatment of like instruments at all financial institutions. If the Committee sees fit to eliminate the

reserve burden for some institutions by exempting a certain level of deposits, we believe that the tax burden of reserves must be eliminated for all institutions. This could be done by an outright removal of reserve requirements. Given the important role reserve requirements play in monetary policy, a more appropriate approach would be to pay a market rate of interest on reserves.

FINANCIAL INSTITUTIONS REGULATORY ACT AMENDMENTS
- Sec. 221-232

The amendments to the Financial Institutions Regulatory and Interest Rate Control Act (FIRA) contained in Part B of Title II of the bill were first transmitted to the Congress by the bank regulatory agencies last year. At that time, the agencies identified these amendments as largely technical in nature and stated that they expected to transmit additional, more substantive amendments as soon as they had reached agreement on the provisions the amendments should contain. Although the agencies have not yet forwarded these additional amendments, our Association has been contacted by literally hundreds of banks expressing their dismay at the unwarranted burden on their operations caused by FIRA.

Of particular concern to banks has been the limits the Act places on a bank's ability to attract and retain qualified directors. Through the advance loan approval requirements, the aggregated single borrower limit, the reporting requirements, and the scrutiny of loan transactions by a bank's entire board of directors, bank directors have been treated as second-class borrowers. Our Association has always felt these restrictions on a bank's dealings with its own senior management to be overly severe. But with the evidence that has become available since FIRA was passed indicating that the presumed abuses at which FIRA was aimed were, in most

cases, virtually nonexistent, we have come to the view that a major overhaul of the restrictions on bank management officials in the Act is in order.

Therefore, although our Association would be supportive of most of the thrust and some of the specifics of the amendments to FIRA contained in Part B we would strongly urge that the Committee adopt the following additional amendments that would leave the intent of FIRA intact while eliminating some of its more burdensome and unproductive provisions:

1. Committees of boards of directors should be permitted to act on loan applications and board approvals could be made after loan consummation when necessary rather than in advance by the entire board of directors;
2. The individual borrower limits applicable to State chartered banks should apply to aggregate loans to bank management officials and their controlled companies or their political campaign committees, rather than the single borrower limits of the National Bank Act;
3. Extensions of credit to subsidiaries of insured banks and bank holding companies without the prior approval requirements of the Act should be authorized. Such loans would continue to be subject to the requirements of Section 23(A) of the Federal Reserve Act as amended;
4. In addition to the Amendments proposed to Section 110, that section should also be amended to permit other personal loans up to \$25,000 for member banks executive officers. In addition, loans secured by deposits in excess of the amount of loans should be permitted without limit;
5. A new subsection should be added to the Change in Bank Control Act to provide that whenever the primary supervisory agency of an

insured bank is a State banking authority, the approval or lack of disapproval of a proposed acquisition by the State supervisor under State law similar to Title VI, shall preempt any requirement of notice and the opportunity to disapprove by the appropriate Federal supervisory agency;

6. Titles VIII and IX of FIRA, on reporting of loans to management officials, should be deleted because they have already been shown to be ineffective, duplicative of other recordkeeping requirements, and extremely onerous for the individuals and banks required to make the reports.

In the opportunity to submit additional comments for the record which we have requested, our Association will be submitting specific legislative language to effectuate these amendments.

UNDERWRITING REVENUE BONDS AND MUTUAL FUNDS
BY FINANCIAL INSTITUTIONS - Title III

Mr. Chairman, Title III of the bill would remove limitations and restrictions of the Glass-Steagall Act to allow banks to provide customers two additional services which are identical in their basic character to other services currently offered.

Section 301 would permit banks to underwrite and deal in revenue obligations of state and local governments. In 1933, when Glass-Steagall was enacted, state and local governments with rare exception issued only general obligation bonds. Congress in enacting a basic prohibition against bank underwriting of securities specifically excluded from the prohibition such general obligation bonds.

Even by 1937, revenue bonds constituted only about two percent of state and local obligations outstanding. But today, the market has changed. In

1980, over seventy percent of the municipal bonds issued were revenue bonds. Thus, if banks are to serve state and local governments in raising needed capital funds the law must be changed.

All the major organizations of state and local governments, such as National Governors Association, National Association of Counties, National League of Cities, U.S. Conference of Mayors, and Municipal Finance Officers Association have endorsed bank underwriting of revenue bonds. The principal reason for this unanimity is the cost savings which would be realized by state and local governments in future issues of these bonds. The magnitude of the savings is a matter of controversy with academic projections running from virtually none to major amounts. Dr. William Silber, Professor of Economics and Finance at New York University, recently reviewed twelve studies by nine different research teams and concluded that based on 1977 data, state and local governments would have saved \$80 million to \$369 million if banks could underwrite revenue bonds.

The reason for the savings are several. First, the added competition would result in lower underwriting fees. Second, bank participation would add liquidity to the secondary market, thus reducing interest costs. And third, bank participation would expose these issues to new investors increasing the size of the market thus reducing interest costs.

Underwriting revenue bonds does not increase risks to banks or bank depositors since Section 301 would limit bank underwriting to those issues the Comptroller of the Currency has approved for bank portfolio investment. We urge passage of Section 301.

Section 302 would authorize banks, bank holding companies, their subsidiaries, savings and loan associations, mutual savings banks, and credit unions to sponsor, operate, advise and sell mutual funds.

The Supreme Court in 1971 construed the Glass-Steagall Act as prohibiting a bank from operating a collective investment fund for agency accounts. The Court specifically recognized that banks could collectively invest trust accounts and individually invest agency accounts. But when agency accounts were invested collectively, the Court held it was tantamount to a mutual fund and contrary to Glass-Steagall. The court held this despite the fact that the assets at risk were those belonging to the investment customers and not the depositors, the same as in the case of a collective trust fund.

The consequence of the decision is that banks cannot provide the experience and knowledge of their trust departments to the smaller investor in an efficient and economic manner. Evidence of this can be found in the fact that banks have not been able to provide an investment for their IRA customers, but rather have had to limit their service to a deposit account subject to Regulation Q interest rate ceilings.

Section 302 would allow a bank to provide to the smaller investor the professional knowledge and experience of its trust department, lower securities transaction costs, investment diversification, and a broader range of investments. There is general agreement among many economists and others that equity investment in American business is the best buy in the world today. Yet, the smaller investor is unable to participate in a really efficient and effective manner in this market. Section 302 would change this. We urge the adoption of Section 302.

To the extent that the provisions of Glass-Steagall that separate commercial and investment banking were enacted to protect depositors and securities investors from abuse, the world has also changed. The Glass-Steagall Act, itself, contains the greatest protection for depositors,

Federal Deposit Insurance. Close on the heels of Glass-Steagall, Congress passed the Securities Act of 1933 to require comprehensive disclosure in the public sale of securities and to prohibit fraud in securities transactions. In 1934, Congress passed the Securities Exchange Act to regulate brokers and dealers, the securities exchanges and to prohibit fraud in the securities marketplace. Subsequently, in 1964 and 1975 that Act was extended to require comprehensive and continuous disclosure by publicly-owned companies and to extend broker/dealer regulation to municipal bond dealers and bank dealers. The Investment Company Act was approved by Congress in 1940, establishing a detailed regulatory scheme for investment companies. This Act was accompanied by the Investment Advisers Act of 1940.

In more recent years Congress has approved the Employees Retirement Income Security Act (ERISA), the Financial Institutions Regulatory and Interest Control Act and other statutes regulating bank activities.

All of these statutes add up to a pervasive system of government regulations to protect depositors and investors from abuses such as those that preceded Glass-Steagall.

Beyond this, both sections of Title III deal specifically with protection for depositors, investors and other bank customers. Section 301 includes a number of limitations relative to the size of a banks' holding of bonds and to conflicts of interest.

The bank sponsored mutual funds established under Section 302 would be registered as investment companies in accordance with the Investment Company Act and subject to the regulatory provisions of that Act. The individuals in the bank who sell the shares of the fund would have to meet standards of experience and training established by the bank regulatory agencies and would have to comply with standards for sales practices set by those

agencies. Compliance is assigned to the appropriate bank agency and provision is made specifically for them to carry out this responsibility. The antifraud provisions of the 1933 Securities Act and the 1934 Securities Exchange Act would be applicable. In short, the depositor, investor and all other bank customers are fully protected.

Mr. Chairman, Title III would allow banks to serve their customers more fully with the necessary regulations whether the customer be the local community or the people of the local community. It should be enacted.

In May, we testified before the Committee on both of these issues. We request that our comments made at that time be inserted at this point in the record of this hearing. (Please see Attachments Nos. 4 and 5.)

USURY PROVISIONS - Title IV

ABA endorses the provisions of Title IV which would preempt state usury ceilings on extensions of consumer credit and make permanent and complete the preemption of state ceilings on business and agricultural credit. The justification for this action is set out in detail in the attached copy of our testimony before the Subcommittee on Financial Institutions given on July 15, 1981. (Please see Attachment No. 6.)

Briefly, with increasing costs of funds to financial institutions and upward pressure on interest rates, banks located in states with restrictive usury ceilings are unable to meet the credit needs of their customers, particularly in the consumer loan area. As a result of these pressures, the need for federal preemption of all state usury ceilings has become a major goal of the financial industry.

The evidence in support of elimination of usury ceilings is conclusive. First, restrictive ceilings have been demonstrated to interfere with the

free operation of the marketplace resulting in a decrease in credit availability. Second, evidence demonstrates that consumer protection arguments in support of usury ceilings are unfounded. Consumers are best served by a competitive marketplace coupled with disclosure of the cost of credit. Finally, the national scope of credit markets and the economic disruption caused by artificial price restraints justify immediate federal action. Because a creditor's costs of funds are determined almost entirely by actions that occur at the Federal level, restrictive state laws governing the rate of return on credit extended should not be allowed.

CREDIT UNION PROVISIONS - Title V

Title V provides additional authorities for the National Credit Union Administration to deal with troubled institutions. As stated previously, we believe that any broadened powers for regulatory agencies must be consistent with the conditions relating to FDIC authority to assist member banks including an early termination date. At the same time, we believe that this type of emergency legislation should not serve to undermine the requirement that restricts credit union membership to those with a common bond absent emergency circumstances. Although most of the remaining provisions of Title V appear relatively noncontroversial, our Association is concerned that insufficient time has been available to review these provisions. Our Association cannot support any additional expansion of credit union powers without the institution of competitive equity through such actions as revocation of their tax-exempt status, loss of their taxpayer-subsidized facilities in Federal buildings, and subjection to similar regulatory requirements as those affecting commercial banks.

BANK HOLDING COMPANY INSURANCE ACTIVITIES - Title VI

The thrust of S. 1720, to quote you Mr. Chairman, is that "... Depository Institutions should have increased flexibility to enable them to engage in profitable activities and to serve better the needs and wishes of their customers...." This legislation is designed to allow depository institutions to compete more effectively in the current financial services marketplace. One need only view the recent acquisitions of securities firms by insurance companies, banks and securities firms by retailers, and depository institutions by steel companies to realize that the marketplace of the financial services industry is definitely changing. While most of the provisions in S. 1720 attempt to address our changing marketplace, by making depository institutions more competitive with those non-depository institutions, we are perplexed that Title VI was included in S. 1720. The American Bankers Association is on record as having opposed this legislation, the last time was before this Committee on July 1, 1980. Although the prohibitions contained in Title VI are specifically designed to preserve the status quo with respect to insurance activities as of June 12, 1980, they are wrong in principle. Specifically:

- o Anti-competitive
- o Statutory prohibition of a specific activity abandons sound public policy established in 1956 and affirmed in 1970.
- o Banks and bank holding companies are now prohibited by law from "tie-in" sales activities
- o Increases regulation.

The consistent posture of bankers is that increased competition should be accommodated by removing restrictions that impose competitive disadvantages on banks. Our membership has again and again indicated that

we are not seeking protection from competition but are seeking a more level playing field on which to compete with ourselves, with other types of financial institutions, and with other less regulated businesses. Title VI is not only inconsistent with our long standing position on competition, but it is inconsistent with the other provisions in S. 1720 which attempts to level the field of play and so Mr. Chairman, we must oppose Title VI of S. 1720.

Should the Committee desire to retain Title VI of this legislation, then Title VI should be amended to include savings and loan holding companies and their service corporations among those to be restricted in insurance activities. Likewise, since existing law prohibits "tie-in" sales by banks and bank holding companies, the same prohibitions should be applied to savings and loan associations and savings and loan holding companies.

INCREASED DEPOSIT INSURANCE FOR IRA AND KEOGH ACCOUNTS
- Sec. 701

Section 701 would increase the deposit insurance on IRA/Keogh accounts from \$100,000 to \$250,000. We recognize the obvious advantages such as increased protection for IRA/Keogh customers as well as the additional inducement for individuals to provide for their own retirement. However, we realize at the same time, that an increase in insurance for certain specialized accounts historically leads to increased levels of insurance for all deposit accounts. Such events would expose the insurance fund to a significantly increased potential liability. This seems untimely under present economic conditions. Additionally, such an increase would also diminish the incentive for well managed institutions to continue to excel in the skills which separate them from institutions which are not as well managed.

INTERNATIONAL BANKING FACILITIES - Sec. 702

On June 9, 1981, the Federal Reserve Board authorized the establishment of International Banking Facilities (IBF's) within the boundaries of the United States commencing December 3, 1981. The basic objective of the Federal Reserve Board was to enable U.S. banks to offer international banking services in the U.S. which are competitive with those offered at offshore financial centers. Under existing provisions of law, the Federal Deposit Insurance Corporation intends to assess the FDIC insurance premium on those deposits taken by IBF's located within the United States, while offshore deposits are now, by statute, exempt from such assessment. Section 702 would exempt deposits at domestic IBF's from both federal deposit insurance assessment and insurance coverage, and is supported by the ABA.

Currently, one-half of the business conducted by offshore branches of U.S. banks consists of interbank placements that typically carry margins of 1/16th of 1 percent, or less than the gross 1/12 of 1 percent FDIC assessment which would otherwise be imposed on the deposits of affected domestic IBF's. Since such margins are so slim, the imposition of FDIC insurance assessments would provide a significant disincentive to the establishment of domestic IBF's. Section 702 would generally make applicable to domestic IBF's, the same exemption now available to IBF's of foreign banks and Edge Act Corporations, thus furthering competitive equality among such institutions. There are three other public benefits that would be gained:

1. U.S. revenues could increase because the taxes on the profits of the international banking business returned to the U.S. would be paid to the Treasury rather than a foreign government.

2. The United States, and its major cities, would enhance its status as an international banking center for offering deposits, loans, and related services.
3. The conduct of international banking business in the United States rather than abroad would facilitate supervisory oversight.

For these reasons, the ABA recommends enactment of Section 702.

TRUTH-IN-LENDING AMENDMENTS - Sec. 703-706

Our position on these amendments to the Truth-In-Lending Act will be set out more fully in a supplemental statement for the record. Let me briefly state our position on each of the proposed amendments.

Section 703 would exempt real estate brokers from the requirements of the Act. Problems associated with real estate transactions under Truth-In-Lending should be addressed in a broader context. We feel that the same policy considerations that dictate in favor of exempting real estate brokers also dictate in favor of an exemption for all first mortgage loans.

Section 704 would provide a complete federal preemption of state disclosure laws coupled with an opportunity for states to "opt out" of the federal law. We support a complete federal preemption of state laws similar to Truth-In-Lending. However, we oppose any option for states to enact laws that in any way differ from the federal law. Such an option is counterproductive to the purpose of the law to promote national uniformity and promote credit shopping and consumer awareness of rates.

Section 705 would amend the civil liability provision of Truth-In-Lending by eliminating the minimum statutory penalty, increasing the maximum statutory penalty and providing that no statutory penalties would be allowed unless the court found that the creditor was in "substantial noncompliance" with the law. ABA supports elimination of all

statutory penalties. If statutory penalties are retained, we would favor a "good faith" compliance standard linked to the "substantial noncompliance" test. This will be discussed more completely in our supplemental statement.

Section 706 would extend the mandatory effective date of changes made by the Truth-in-Lending Simplification and Reform Act for six months. We support such an extension.

In summary, Mr. Chairman, we thank you for introducing S.1720, and thank the Committee for its prompt attention to the public policy issues addressed in the bill. With the exception of Title I-Parts A and B (bank-like powers for thrift institutions), Section 211 (exemptions from reserve requirements), and Title VI (prohibited insurance activities), the American Bankers Association supports S. 1720, and will work for its enactment. I have stated, we recommend some amendments to other provisions of the bill and will provide additional comments to the Committee prior to the close of these hearings.

AMERICAN BANKERS ASSOCIATION

October 20, 1981

Statement on S. 1686

On September 30, 1981 Senator Lugar introduced S. 1686, a bill designed to provide greater returns on state, local, and Federal government deposits. On October 16, 1981, we were requested to comment on S. 1686. Governmental units already enjoy several advantages over other classes of depositors. Their accounts must be collateralized in most states, and they can earn a higher rate of interest on their time deposits than on other deposits of comparable maturity.

The first section of this bill would eliminate reserve requirements on demand deposits of Federal, state, and local governmental units. The sole purpose of imposing reserve requirements on any category of account is to effectuate monetary policy. While our Association could agree that a reexamination of the Monetary Control Act may be appropriate in order to determine, among other things, the effectiveness of reserve requirements that do not act upon over \$160 billion held as near money in money market mutual funds, piecemeal treatment of reserves on governmental units seems inappropriate.

The second section of S. 1686 would direct the Depository Institutions Deregulation Committee to increase the ceiling rate of interest on public unit demand deposits to the maximum rate payable on other such accounts. Although it is not entirely clear how the bill would increase ceilings on demand deposits where there are presently no ceilings, it is clear that the intent of this section is to ignore the clear agreement of Congress to phase in interest rate deregulation over six years. Because the Depository Institutions Deregulation Act of last year retained the Banking Act of 1933's prohibition on the payment of interest on demand deposits, the Deregulation Committee cannot legally allow any payment of interest on public unit demand deposits until April 1, 1986. We support the continued phase in of deregulation, and cannot agree that Congress' intent to defer the removal of interest payment prohibitions on demand deposits should be altered before the phase-out of deposit interest ceilings on time deposits has yet begun.

The bill's third section would authorize public unit depositors to maintain NOW accounts. It would repeal a provision of the Depository Institutions Deregulation Act limiting NOW accounts to individuals and certain nonprofit organizations, and overturn a recent decision won by ABA in the U.S. District Court for the District of Columbia clarifying that Congressional intent. Under the Deregulation Act, public units would be entitled to interest on their NOW accounts in 1986. We continue to support this phase-out schedule enacted by Congress allowing depository institutions ample time to prepare themselves for the higher cost deregulation will bring.

Mr. Chairman, we must oppose S. 1686.

ATTACHMENT I

SUBJECT: Recent Government Actions to Help Specialized Thrift Institutions

Since July 1st, Federal legislative or regulatory actions taken to help thrift institutions include:

- o Interest Rate Futures — On July 2, the FHLBB issued regulations to permit S & Ls to use any interest rate futures contract designated for trading by the Commodity Futures Trading Commission, provided that the security on which the futures contract is based is one in which federals are legally authorized to invest. In addition, instead of authorizing the specific types of hedge transactions in which an association may engage, the regulation provides general authority to use futures contracts to reduce the net interest rate risk exposure to which associations are subject. Examples of hedging transactions that could achieve this purpose include short futures positions taken to hedge firm commitments to originate or purchase mortgages or mortgage-related securities, to protect against declines in value of portfolio investments, to fix liability costs, and to hedge the maturity "gap" which arises from borrowing short and lending long. Also permitted under the amended regulation are long futures positions taken to hedge firm commitments to sell mortgages not yet originated for those

associations that engage in mortgage banking-types of operations. The position limit — an amount equal to the net worth of an association under prior regulations — has been eliminated.

- o All Savers Certificates — Sec. 128 of the Economic Recovery Tax Act of 1981 (P.L. 97-34) provides for the creation of All Savers Certificates for use by banks, credit unions, and thrifts. The U.S. League of Savings Associations estimates that the thrifts will pick up about \$162 billion of the \$250 billion that the certificates are expected to generate. Deposit costs for both banks and thrifts are expected to be reduced, and this reduction in deposit costs could be expected to greatly lessen the squeeze on S & L operating margins. On September 3, 1981, DIDC adopted All Savers Certificate Regulations. DIDC further clarified these regulations in a Question and Answer Press Release issued September 21, 1981.
- o Geographic Restrictions on RSUs — On August 6, 1981, the FHLBB issued a final rule taking effect immediately to grant Federally-chartered S & Ls and mutual savings banks the authority to establish and use remote service units on a nationwide basis. In removing geographic restrictions on RSUs, the Bank Board said that liberalization was necessary to correct a competitive imbalance between S & Ls to provide their out-of-state customers with convenient and cost-efficient services. The new regulations are more liberal than regulations applying to national banks.
- o Amortization of Mortgage Losses — On August 13, the FHLBB proposed regulations to permit S & Ls to spread the impact of the sale of mortgage losses over the remaining life of the mortgages

sold instead of reporting the loss in the year of the sale. While the rule is applicable to all insured S & Ls, stock associations could not use this procedure since their balance sheets must be approved by a certified public accounting firm, which insist that losses in sales must be reported on the income statement covering the period in which the sale was made. FNMA has announced that when these accounting regulations become final, it expects to be a buyer of low-yielding mortgages at a discount.

- o Mortgage Corp. Swap — On August 17th, the Federal Home Loan Mortgage Corp. announced a mortgage swap program. Under this program, lenders of all types would be permitted to sell packages of mortgages to the Mortgage Corporation on a bid basis. The Mortgage Corporation would then purchase these mortgages and assemble them within a Participation Certificate, where the Corporation guarantees timely payment of interest at the applicable rate and full return of principal. The mortgagee would then buy back the PC, now a mortgage-backed security, which the lender can then use as a security for repurchase agreements or sale to investment bankers. Thrifts hold about \$60 billion of mortgages, the size of the Mortgage Corporation's program in 1981 is estimated at \$2 billion and perhaps \$20 billion in 1981. H.R. 4515 has been introduced in the House to give both FNMA and the Mortgage Corp. expanded authority to purchase mortgages more than one year old.
- o Fed Reserve Account — On August 20th, the Fed Reserve put into effect an extended credit program to provide emergency funds for financial institutions at a rate of 14 percent annual rate for the

first 60 days of the borrowing, 15 percent for the next 90 days, and 16 percent thereafter. This compares with the 19 percent S Ls pay on advances from the Home Loan Bank System.

- o Income Capital Certificates — The week of August 31st, FHLBF announced the creation of Income Capital Certificates and of FSLIC Promissory Note. Income Capital Certificates are is: a mutual savings and loan association to the Federal Savings Loan Insurance Corporation, pursuant to a form of Master prepared by the FSLIC, in exchange for a five-year prom of the FSLIC. ICCs are a unique form of equity security designed as a hybrid between traditional debt and equity securities. They provide for Annual Income Payments equivalent to dividends or interest, and annual redemptions, but in each case only if (1) the issuing loan association has net income, with payments being specified percentages of such net income and (2) worth standards are met. It is expected that ICCs will be treated as equity on the balance sheet of the association in accordance with generally accepted accounting principles. This is primarily because the Income Capital Certificate is only to the extent of specified percentage of net income by the issuing association from any net income in equity securities. Annual redemptions of the value of the Income Capital Certificates will be based on the income of the savings and loan association. The worth is equal to or greater than 25 percent of the net worth provided, however, that aggregate redemptions



to prior payments of all accumulative amounts due with respect to Annual Income Payments, cannot exceed 75% of its net income or reduce its net worth to less than 2% of its total assets.

- o FSLIC Promissory Notes — are a five-year promissory note issued by the Federal Savings and Loan Insurance Corporation to purchase Income Capital Certificates issued by a mutual savings and loan association. They are Payable semiannually at a rate equal to (i) the average during the last month of such period of the arithmetic average of equivalent bond yields for the most recent U.S. Treasury five-year note plus (ii) one-half of the difference between the average of the daily closing equivalent bond yields on a new Farm Credit consolidated obligations and Federal Home Loan Bank System obligations issued within the last three months of such period and the arithmetic average equivalent bond yield on U.S. Treasury obligations of the same maturity during the same period.

It is expected that the FSLIC note will be treated as a cash equivalent on the balance sheet of the savings and loan association to which it is issued, in accordance with generally accepted accounting principles, in an amount equal to the fair market value of the note at the date of issuance. The note also can be utilized by the association to satisfy its regulatory net worth and liquidity requirements.

- o Citizens Federal Merger — On September 4, the Federal Home Loan Bank Board — through the Federal Savings and Loan Insurance Corp. — converted Washington Savings Association of Miami, Florida from a state to Federal charter. West Side Federal of New York, New

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York was then merged into Washington. Washington was next converted to a stock company. Following this, Citizens converted from a California state-chartered institution to a Federal stock S & L. The charter change was needed because state associations cannot merge. National Steel, which owns United Financial Corp., parent of Citizens Federal, agreed to infuse \$75 million in equity into the S & L over the next 36 months.

ATTACHMENT II

Table 1
Distribution of Savings and Loan Association
Grouped by Net Worth as a Percent
of Total Assets and Size
(December, 1980)

Net worth as a percent of total assets	0 to 50	50 to 250	Size of Institutions 250 to 1000	Over 1000	Total
less than or equal to 0.0	15	0	0	0	15
0.0 - 1.0	56	3	0	0	59
1.0 - 2.0	45	24	9	2	80
2.0 - 3.0	102	68	19	6	195
3.0 - 4.0	175	215	70	20	480
4.0 - 5.0	281	387	111	22	801
5.0 - 6.0	263	247	87	18	715
6.0 - 7.0	240	250	68	9	567
7.0 - 8.0	184	173	22	4	383
greater than 8.0	489	188	15	15	707
Total	1,850	1,655	401	96	4,002

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Table 2
Percent of Industry Assets Held by Savings and Loan
Associations Grouped According to Size of Institutions
and its Net Worth as a percent of total assets.
(December, 1980)

Net worth as a percent of total assets	0 to 50	50 to 250	Size of Institution (\$ Million) 250 to 1,000	Percent of Industry Assets Over 1,000	Total
Less than 0.0	0.02	0.00	0.00	0.00	0.02
0.0 to 1.0	0.10	0.06	0.00	0.00	0.16
1.0 to 2.0	0.15	0.39	0.64	0.45	1.64
2.0 to 3.0	0.40	1.27	1.33	1.58	4.58
3.0 to 4.0	0.76	3.87	5.29	5.22	15.14
4.0 to 5.0	1.23	6.83	8.03	6.32	22.42
5.0 to 6.0	1.16	6.49	6.53	4.77	18.96
6.0 to 7.0	1.05	4.76	4.65	2.33	12.79
7.0 to 8.0	0.75	3.04	1.51	0.88	6.18
More than 8.0	1.46	3.16	0.98	12.51	18.11
Total	7.09	29.87	28.97	34.07	100.00
More than 8.0					

PUBLIC BENEFITS OF LIBERALIZATION OF THE ACCEPTANCE LIMITATION
- Sec. 209

The proposed liberalization of the 1915 acceptance limitations would have five principal benefits. The first benefit would be the enhanced ability of a regulated sector of our economy to compete with unregulated credit sources. Many customers who would like to, but for various reasons do not, obtain bankers acceptances will usually obtain funds through sources of credit that are presently unregulated, such as commercial paper. In addition, acceptances are available from foreign banks which generally do not have any limitations on the acceptances that they generate abroad in their own markets. Relief from the present limitations would permit member banks to compete more effectively with these unregulated credit sources.

Second, acceptance financing for smaller U.S. exporters and agricultural concerns would be increased. Because demand for acceptance financing exceeds the present limitation, banks must allocate acceptance credit among customers. Other customers are either unable to obtain acceptance financing or must pay a premium for such financing. Again, relaxed limitations would increase the number of customers for whom acceptance financing is available.

Third, eligible acceptances are considered to be one of the highest quality forms of obligation, from the perspective of both the bank that provides the financing and the purchaser of the acceptance from the bank. This high quality reflects the very nature of the acceptance. An acceptance created under Section 13 of the Federal Reserve Act is short-term (in no case may its maturity exceed 180 days from the time of acceptance) and is self-liquidating from the proceeds of the underlying transaction. We believe banks should be encouraged to make this type of non-speculative,

productive credit extension. A relaxation of these limitations would provide such encouragement.

Fourth, the availability of additional bankers acceptance financing would make a significant contribution to the United States' position as a center of international trade and finance. As previously indicated, the current acceptance limitations are no longer reasonable in light of the growth in international trade and finance over the past 65 years and the competition arising from unregulated foreign banks.

Finally, an increase in this low cost form of financing may help to reduce the trade deficit which the United States has been experiencing. The favorable impact should be felt on both the export and import sides of the equation. Any relaxation in the acceptance limitations would facilitate the ability of United States exporters to obtain this low cost form of financing and, accordingly, to enhance their competitive position vis-a-vis foreign exporters which are able to obtain acceptances from banks not subject to limitations. Sec. 209 would also enable more United States importers to avail themselves of low cost acceptance financing and, thus, reduce the total cost of U.S. imports.

ATTACHMENT IV

ISSUE: BANK UNDERWRITING OF REVENUE BONDS ISSUED BY STATE AND
LOCAL GOVERNMENTS

Legislation is needed now which would permit banks to underwrite and trade in revenue bonds issued by state and local governments.

Commercial banks have been legally authorized for many years to underwrite and trade in general obligation bonds of state and local governments, and in doing so have contributed importantly to creating an efficient market for the financing of state and local government capital requirements. Because of tax-limitation measures being imposed on state and local governments all governmental units are relying to a growing extent on revenue bonds to meet project financing requirements (water, sewer, hospital, recreational facilities, etc.). Revenue bonds accounted for over 70% of all new municipal bonds issued in 1980 — a dramatic increase from 33% in 1970. Banks are prohibited by the Banking Act of 1933 (the Glass-Steagall Act) from being underwriters in this now major section of the Municipal securities market.

The principal public policy reason for legislation to allow banks to underwrite revenue bonds is the substantial savings it will provide state and local governments and their taxpayers without any new federal expenditures. The magnitude of the savings is a subject of heated debate, with various academic experts on various sides of the issue. However, a recent comprehensive review by Dr. William Siller, Professor of Economics and Finance at New York University of 12 studies by nine different research teams, concluded that a conservative methodology applied to 1977 data "produced dollar savings between \$80 million and \$369 million" for state and local governments.

There are two principal reasons that bank competition for municipal revenue bonds will save money for state and local governments. First, increased competition in a market now served exclusively by broker/dealers will reduce the fees imposed by underwriters for bringing a new issue to market. Second, bank participation in the secondary market will lower interest rates issuers pay by increasing the liquidity of municipal revenue bonds.

The legislation we seek would permit banks to underwrite and trade only in investment grade municipal revenue bonds, already considered safe enough for banks to invest in. It would not permit banks to underwrite or trade in corporate securities. The legislation contains numerous safeguards against any possible abuse, and it requires an annual report by the Secretary of the Treasury so Congress can regularly assess the impact of bank eligibility.

Recognizing the potential public benefits of this legislation, endorsement of the legislation has come from many public issuer groups including the National League of Cities, the National Association of Counties, the Municipal Finance Officers Association, the National Governors Association, the National Association of State Auditors, Comptrollers and Treasurers, the U.S. Conference of Mayors, the Airport

Operators Council International, and others. In the past, major support has also come from such Federal agencies as the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and representatives of the Department of the Treasury.

Legislation permitting banks to compete in the municipal revenue market has passed the Senate twice since the mid-1960s, but has been blocked in Subcommittee in the House. This legislation is now ready for prompt action.

ATTACHMENT V

ISSUE: AUTHORIZE BANK COMMINGLED AGENCY ACCOUNTS

Another response to the impact that money market funds have had on banks and S&Ls is to allow banks and S&Ls to offer their own money market funds. Such funds would not bring directly to the banks and S&Ls deposits for their use in meeting housing, consumer and other credit needs, but they would offer them the opportunity to retain their customers who decide to withdraw their deposits and invest them in money market funds. Then, as Reg Q is relaxed and as short-term interest rates drop, the bank customer may more readily and easily return to insured deposits. Bank and S&L money market funds would ease disintermediation by keeping customer funds under the management control of local banks and S&Ls rather than seeing the funds flow to the control of money centers. Further, there should be an increased incentive and capability on the part of these money market funds to invest in CDs and other short-term instruments of nonmoney center banks and in a broader range of commercial paper.

Banks possess a competence and experience in investing short term that is unsurpassed. In fact, banks serve as investment advisers to many of the current money market funds. American savers should be given the benefit of this competence by allowing bank and S&L competition with the current funds. We urge the Committee to approve legislation that would allow banks and S&Ls to sponsor and sell shares of a mutual fund.

The idea of banks and S&Ls offering mutual funds did not originate with the phenomenon of the money market fund. Banks have sought this authority for almost twenty years.

In 1962 the Congress transferred regulatory authority over national bank trust departments and bank collective trust funds to the Comptroller of the Currency from the Federal Reserve Board. It also in that year enacted the Keogh Act authorizing retirement plan deductions for the self-employed. A controversy quickly developed between the Comptroller and the Security and Exchange Commission regarding the jurisdiction of the SEC over the collective investment by banks of agency account and Keogh plan assets.

The Comptroller adopted regulations in early 1963 authorizing and regulating the collective investment of both types of accounts. Neither the Comptroller nor the SEC questioned the legality of banks operating such funds. Rather the issue between them was whether the funds were subject to the securities laws. Legislation was introduced in Congress that year that would specifically authorize banks to collectively invest agency accounts and to do so subject only to regulation by the Comptroller. In addition Keogh plan collective trusts under the legislation would have been exempted from the securities laws.

One bank in 1965 decided not to wait for legislation but to move ahead in offering commingled agency accounts. It received approval from the Comptroller and acquiesced to the jurisdiction of the SEC, receiving a number of specific exemptions from the Investment Company Act of 1940. The Investment Company Institute soon after brought suit against the Comptroller and the SEC which ultimately, in 1971, resulted in the U.S. Supreme Court, in ICI v. Camp, ruling that the Glass-Steagall Act

prohibited banks from offering commingled agency accounts to their customers.

In the meantime, in 1969, the Senate passed a bill that included authority for banks and S&Ls to sponsor and sell mutual funds or commingled agency accounts. The legislation paralleled the bank fund offered in 1965 by subjecting banks and S&L mutual funds to the securities laws, with certain statutory exceptions from the Investment Company Act. It placed regulation of sales activities with the Comptroller of the Currency and the Federal Home Loan Bank Board. The House deleted the authorization provision from the bill and, with the Supreme Court decision imminent, the Conference Committee dropped the matter completely from the legislation.

Banks have continued to seek this legislation because it would allow them to meet a need of the smaller investor who is so often overlooked. Collective investment of the assets of smaller investors would allow greater diversification for the protection of the investor. It would provide greater investment opportunities because the size of some investments may be beyond the reach of individual small investors. It also would allow lower brokerage costs because of the increased size of purchases and sales. These advantages, when coupled with the operational capabilities of banks, would offer smaller investors an opportunity they may not enjoy today. In fact, the easy accessibility of bank services should provide professional investment management to a whole new group of small investors.

Because it provides a needed and readily available service to the smaller investor, bank sponsorship and sales of mutual funds should encourage additional savings and investment in our capital markets.

The ABA has prepared a draft proposal that would authorize banks and S&Ls to sponsor and sell mutual funds. The funds would be fully subject to the Securities Act of 1933 and the Investment Company Act of 1940, thus providing regulatory equality.

The bill further would allow banks and S&Ls to sell the shares of any other bank or S&L sponsored fund. Thus, smaller banks and S&Ls that could not sponsor their own fund could join together and sponsor a joint fund whose shares could be sold by each bank or S&L or they could merely sell the shares of another bank's or S&L's fund.

Banks are exempt from the broker-dealer definition of the Securities Exchange Act and the proposed draft would similarly exempt S&Ls for the purpose of selling bank or S&L mutual fund shares.

In place of the Exchange Act, the Comptroller of the Currency and the Home Loan Bank Board are directed to establish standards of training and experience for sales personnel and sales practices.

Finally, the bill prohibits all mutual funds including present money market funds from redeeming shares by a third party check or instrument. The entry of banks and savings and loan associations in the mutual fund field would provide the American investing public with a wider choice of investment media provided by a variety of sponsors.

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The bill would encourage a greater utilization of the investment resources and talents of financial institutions by eliminating a significant arbitrary barrier to competition. Competition for investors' favor under equal rules, which this bill establishes, is an important step toward insuring a healthy financial marketplace and fair treatment to the investing public. The Association, in 1979, commissioned Professor Santomero of the Wharton School to study the economic impact of bank-sponsored mutual funds.

We urge the Congress to adopt this or a similar proposal to allow banks and S&Ls to sponsor and sell mutual funds.

NOTE: The American Bankers Association also submitted for the record the statement made on July 15, 1981, before the Financial Institutions Subcommittee of the Senate Banking Committee. That hearing, on S. 1406 and S. 963, is titled "Credit Deregulation and Availability Act of 1981," and is obtainable in Room 5310 of the Dirksen Senate Office Building, Washington, D.C. 20510. The ABA statement is on page 297 of that volume.

**STATEMENT OF ROBERT L. McCORMICK, JR., FIRST VICE
PRESIDENT, INDEPENDENT BANKERS ASSOCIATION OF
AMERICA**

Mr. McCORMICK. Mr. Chairman, my name is Robert L. McCormick, Jr. I am first vice president of the Independent Bankers Association of America and president and chief executive officer of the Stillwater National Bank and Trust Company of Stillwater, Okla.

IBAA represents over 7,300 national and State-chartered small and medium-sized banks in 48 States and the District of Columbia. Most of our banks serve rural and suburban markets. Measured by asset size, most of our banks are small with more than 80 percent having assets of \$25 million or less.

While banks of this size account for less than 10 percent of all commercial bank assets, they nevertheless supply most of the credit needs of households, farmers, and small businesses in their respective communities. This is reflected in the relatively high proportion of their assets invested in loans to farmers. Approximately 40 percent of their assets are in agricultural loans, compared to an industry average of only 3 percent. In addition, while the national average of loans to individuals is 13 percent of assets, our banks show an average of 17 percent.

We are pleased to appear before you today, Mr. Chairman, to comment primarily on S. 1703, the Administration-developed bill which you introduced by request on October 5, and on S. 1720, the Financial Institutions Restructuring and Services Act of 1981. At the end of our testimony we will briefly comment on S. 1721, which proposes the merger of the financial institutions insurance funds; and S. 1686, which was introduced by Senator Lugar and addresses reserve requirements and NOW accounts for State and local governments.

S. 1720, as introduced by Chairman Garn, includes the major recommendations of the administration and Federal Home Loan Bank Board Chairman Pratt for increasing the flexibility and authority of Federal agencies in dealing with troubled savings and loan institutions.

EMERGENCY ATMOSPHERE CREATED

We share the concern of the Federal regulatory agencies and this Committee over the problems facing some of our financial institutions, particularly savings and loan associations and mutual savings banks. However, we fear that a sweeping restructuring of the Nation's financial industry is being pressed forward with greater haste than necessary under the debatable contention that the existing thrift crisis requires such drastic measures.

The emergency atmosphere created by conditions prevailing in some sectors of the financial industry has already prompted the adoption of a variety of remedial measures. These measures include the All Savers Act, expanded IRA/Keogh authorizations, the opening of the Fed discount window to the thrifts, authorization for new flexible interest rate mortgages, new accounting procedures looking toward helping thrifts dispose of low-yielding mortgages, capital infusion devices, et cetera. And we are now rushing into the consideration of comprehensive new legislation before the effects of

the previously adopted legislation and regulatory measures are known.

Before addressing some of the specific provisions of the four bills before this committee, I must point out that while the Independent Bankers Association is on record in support of some of these proposed changes and reiterates that support today, we are adamantly opposed to the committee's adoption of such far-reaching changes in our Nation's financial structure in an omnibus package hurtling down a legislative fast track. S. 1720 contains seven titles. Each of them is highly significant, has serious ramifications, and deserves to stand or fall on its own merits. To lump them together may increase the odds that a legislative package will emerge from this committee, because the competing views of interest groups will inevitably tend to cancel one another out.

But this legislative stew does not guarantee that the legislation which emerges will be either fundamentally sound or better meet the needs of our economy or of the consumer of financial services in our Nation. Specifically, if an act of Congress begins the process of destroying the concept of specialized financial institutions such as the thrifts by according thrifts all commercial bank powers, who will finance the future housing needs of America?

Supposedly, we are being forced to take this step by the force of circumstances—namely the critical financial situation of the thrift industry. Yet we have not heard any responsible person claim that this bill will help solve the short-term problems of the thrift industry. Fed Chairman Volcker has testified before the House Banking Committee that the issues joined in the Regan-Pratt bill—which are encompassed in title I of S. 1720, that is, a basic restructuring of the thrift industry—are “not going to bear on the earnings and viability of those institutions” over the near term. And the American Banker reported on October 14 that Fed Vice Chairman Schultz told the National Savings and Loan League that thrift institutions would likely suffer severe loan losses if they were allowed to make commercial loans.

In short, this Association sees none of the kind of relief that thrifts now need coming from any of the bills before us today. Rather, we suggest attention be immediately turned to the core of the problem: the thrifts' low-yielding mortgage portfolio does not generate enough income to prevent an immediate and serious deterioration of net worth during this high interest rate climate. A positive solution to meet this real need must be devised quickly. The usual objection to all the proposals that the thrifts themselves have offered, ranging from the warehousing of low-yielding mortgages to outright subsidization by the Federal Government of such loans, is that it will cost Washington too much money in a time of austerity.

These solutions have not had enough investigation to be rejected in an out-of-hand fashion. For instance, currently pending before this committee is S. 984, introduced by Senators Moynihan and Heinz, providing for an “off-budget” swapping arrangement of low-yielding mortgages for variable rate, nonnegotiable notes of the FDIC and FSLIC, to be redeemed within 3 to 10 years.

This bill, and other suggested solutions to the low-yielding mortgage problem, should receive quick and intense consideration from

the committee. Such solutions look toward maintaining thrifts as profitable specialized lending institutions which have played, and must continue to play an indispensable role in meeting the housing needs of our Nation.

Mr. Chairman and members of this distinguished Committee, we also would be remiss in our testimony if we did not express our dismay over the blueprint that Treasury Secretary Regan has drawn for the restructuring of our Nation's financial industry in two major speeches on September 14 and 18. The major bills before you clearly begin to implement this comprehensive restructuring plan.

RESTRUCTURING MEANS A LEAP BACKWARD

Secretary Regan's views on the need for a comprehensive overhaul of our Nation's financial laws are well known. Essentially they propose a great leap backward into the laissez-faire days of Coolidge and Hoover. He clearly wants to do away with the banking reform laws passed in the 1930s after the great crash. He wants to do away with interest rate regulation promptly even if it bankrupts additional thrifts. It was only late last week, after a crack U.S. League political assault division came to Washington that the Secretary was deflected from this ill-conceived course.

He wants to abolish the separation of investment banking from commercial banking and do away with the prohibition against commercial bank participation in the securities business. He wants to combine Federal regulatory agency powers in Washington. And, yes, he wants to open the door to allow the financial giants to cross State lines and bid for local deposits in local communities without regard to State laws, the dual banking system, or where such siphoned funds will be ultimately utilized. This is against the back-drop of smaller banks' having far higher capital requirements than do their big city banking counterparts—not to mention the legally nonexistent capital and reserve requirements of Merrill Lynch.

In his interview in Friday's Wall Street Journal, the Secretary suggested that these legislative proposals do not address interstate banking questions. It is our contention that these proposals directly challenge both the McFadden Act and the Douglas amendment, in addition to undermining countless State banking laws, by making thrifts which have far more liberal intra- and interstate branching rights into commercial banks.

The oft-stated prescriptions of the Treasury Secretary and the parallel prescriptions of the Justice Department under Baxter inevitably will lead to significantly increased financial concentration and a dramatic reduction in the number of financial decisionmaking centers in our Nation. We strongly oppose this economic and financial blueprint as contrary to the interests of our members and to the hundreds of thousands of consumers, small farmers, small businessmen, and homeowners which we serve. We believe the Secretary has overlooked the vital role credit unions, thrifts, realtors, brokers, and insurance agents have played in the past and should play in the future in providing services for the consumer of financial services. With these caveats expressed, I will proceed to discuss the position of the Independent Bankers Association regarding some of the specific provisions of these bills.

To specifically comment on S. 1720 and S. 1703:

Title I of S. 1720 and title II of S. 1703 give thrifts almost all commercial bank investment and lending powers. They would permit Federal thrifts to (1) issue overdraft loans with respect to any transactions account; (2) invest up to 100 percent of assets in loans secured by residential or nonresidential real property; (3) invest in each other's time and savings deposits; (4) invest up to 100 percent of assets in State or local obligations; (5) invest up to 100 percent of assets in secured or unsecured loans for commercial, corporate, business, or agricultural purposes; (6) invest up to 100 percent of assets in commercial paper and corporate debt securities; (7) invest in a wide variety of mutual funds; (8) invest in consumer loans including inventory and floor planning loans, equipment leasing, and educational loans.

It has been the consistent position of IBAA that further expansion of the lending and investment powers of thrift institutions would (a) drastically curtail the flow of funds into housing by fostering a shift into short-term assets; (b) push thrift institutions away from their field of specialization and into a full service commercial banking mode; and (c) create a dual set of rules governing commercial banks on the one hand and commercial banks operating under the guise of thrift chartered institutions on the other.

The original statutes creating thrifts as specialized institutions were an essential part of a national housing policy to broaden the base of homeownership and to provide adequate housing for the Nation's families. Giving thrifts commercial banking powers can only aggravate the current crisis of the housing industry and make it more difficult for families to satisfy their urgent and growing housing needs.

The inevitable consequence of the proposed expansion of thrift powers will be to create a new type of commercial bank operating under a more advantageous regulatory structure than that which presently governs Federal and State-chartered commercial banks. Thrift institutions have historically been granted special privileges in return for investing primarily in mortgages, including tax advantages and the protection of Regulation Q with its differential. These titles, while granting thrifts asset powers approaching those of commercial banks, fail to remove the special privileges designed to induce them to specialize in mortgage lending.

INEQUALITY OF TREATMENT

Further, evidence of the inequality of treatment commercial banks would encounter if these titles become law is found in the difference in treatment of capital reserves. Thrift institutions are permitted to maintain relatively smaller capital reserves than commercial banks—approximately 50 percent below the reserves required for commercial banks. These titles also open the door to interstate branching for thrifts by permitting thrifts—which meet the asset compositions test, imposed by subparagraph (c) of section 7701(a)(19) of the Internal Revenue Code—to operate branches outside the State in which the thrift has its home office. Thrifts which gain the equivalent of commercial bank assets powers could—as we view this provision of the bill—branch across State lines, while

commercial banks would be prohibited from doing so under the McFadden Act.

Both bills, in their provisions dealing with bank and bank holding company takeovers of failing thrifts, track section 8 of the House Banking Committee-passed Deposit Insurance Flexibility Act, and provide the FSLIC and FDIC with broad powers to merge and consolidate thrift institutions and commercial banks in severe financial straits.

Under these provisions, the paramount consideration in authorizing such mergers and consolidations is the need to minimize the financial assistance required from the insurance agencies.

By elevating the protection of the insurance fund to a position higher than other public interest considerations, this provision allows the regulators to permit interstate acquisitions of failing institutions without requiring the exhaustion of potential intra-state solutions. Cross-industry and interstate mergers and consolidations should have the approval of appropriate State authorities. This would both insure that all public interest considerations are taken into account and give due deference to the State's prerogatives concerning the desired financial structure of that area.

We are confident that the Federal insurance agencies, under present statutes, have the capability and resources to cope with the weakening or failure of a substantial number of small thrift institutions without depleting their reserves. The primary justification for the emergency powers for bank takeovers of failing thrifts set forth in this bill is the potential threat created by the failure of a substantial number of very large institutions which might place a very severe drain on the resources of the insuring agencies.

Therefore, any legislation dealing with this problem should focus on the remedies necessary to deal with the failure of the very large institutions.

Similarly, we are not aware of any major commercial bank of more than \$2 billion in assets which faces likely failure over the next 12 months, and thus strongly recommend that the breaching of the Douglas amendment be limited to bank holding company takeovers of failed mutual savings banks of more than \$2 billion in assets. In this regard we find it significant—and hope that the committee does, also—that the administration bill, S. 1703, does not contain provisions permitting bank holding company takeovers of failed banks.

Furthermore, to avoid conflicts with state law regulating bank branching, any large thrift that might be acquired under the provisions of this bill by a bank or bank holding company should be made subject to the bank branching laws of the State in which its home office is located. This would prevent the bank or bank holding company from gaining a competitive advantage over other banks or bank holding companies by acquiring a thrift institution with broader branching powers than those available to commercial banks. The House Banking Committee has accepted this amendment, which apparently enjoys regulator support. Similarly, the Congress should impress upon the regulators the importance of limiting financial concentration.

In title II of S. 1720, we endorse section 201, which clarifies and liberalizes the statutory lending limits affecting national banks.

Inflation has increased the size of loans required by many small businesses and farmers, necessitating the elevation of lending limits. The bill would raise the existing lending limit for a single borrower's unsecured loan from 10 percent to 15 percent of unimpaired capital surplus, and provide for an additional 10 percent on loans secured by readily marketable capital.

Inasmuch as there is an active movement on the part of independent banks to organize "bankers' banks," we find section 205 of title II an important contribution to this movement, which we support.

We also favor section 211 of title II, which would exempt financial institutions with deposits of \$5 million or less from the reserve requirements of the Monetary Control Act of 1980. However, we believe the exemption should be raised to include a broader category of small banks. The burden and costs of compliance outweigh the role these banks play in the conduct of monetary policy, and we urge that the exemption level be raised to relieve the small banks of this burden.

The amendments to FIRA in part B of title II are long overdue, and we believe they will overcome some existing legislative provisions which have been so troublesome to all commercial banks.

We also support title III of S. 1720 which would permit national banks to deal in and underwrite revenue obligations issued or guaranteed by or on behalf of a state or any political subdivision thereof, if such obligations are eligible for purchase by a national bank for its own account.

In the absence of appropriate regulation of money market mutual funds—which we strongly support—IBAA has no alternative except to support title III, which also would permit banks, bank holding companies, S. & L.'s, mutual savings banks, and credit unions to organize and operate an investment company as well as underwrite, distribute, sell or issue securities of any investment company. This would provide the means by which financial institutions could compete with money market mutual funds and halt the heavy loss of deposits to institutions not regulated by depository institution regulators.

But in his Friday Wall Street Journal interview, Secretary Regan limited such new tools to bank holding companies, and most small banks are not structured as bank holding companies. Apparently he does not want small banks to compete with Merrill Lynch.

TOTAL OPPOSITION TO COMBINE INSURANCE FUNDS

With respect to S. 1721, which proposes to combine the insurance funds of the FDIC, FSLIC, and NCUSIF, we are in total opposition.

The FDIC has the soundest base of all three corporations. Moreover, this foundation has been carefully nurtured and financed for over 48 years by commercial banker contributions that far exceed any stakes which the Treasury or the Federal Reserve—both of which originally capitalized the Corporation; or which any mutual savings banks—who have paid proportionately lower premiums than commercial banks—have in the FDIC. S. 1721 basically is a proposal to take banking's relatively healthy insurance pool and unload the problems of the thrifts and credit union insurance funds into it.

S. 1721 presents another problem in which the association has an intense interest. For many years, we have complained that the capital requirements of small banks have been kept at a punitively high level when compared to requirements imposed on larger banks. During a key speech to the American Bankers convention on October 3, 1981, Quentin Thompson, Director of Bank Supervision of the FDIC, suggested an answer which we believe, from initial investigation, to be worthwhile: A variable FDIC insurance premium that allows well-capitalized and sound banks to pay less to the Corporation than riskier banks. We believe a merger of the FDIC/FSLIC/NCUSIF would thoroughly undermine any chance this solution has to address the capital inequality problem.

Mr. Chairman, thank you for asking me to testify. It was not that long ago that we were testifying here before this committee to urge caution with respect to another major piece of legislation then pending before it. That legislation looked toward giving the Federal Reserve the necessary tools with which to conduct a precise monetary policy, and to giving the thrifts new asset and liability powers designed to see them through the difficulties they were facing. That bill was signed into law on March 31, 1980, and is still being implemented. Against the backdrop of old panaceas that did not have their intended effect, we should approach the new panaceas being offered today with extreme caution. And we should be skeptical enough to realize that they may be part of a game plan looking to totally restructure the provision of financial services that will severely disadvantage many of the smaller providers of financial services, and their millions of customers.

Thank you.

[Complete statement follows:]

S T A T E M E N T

OF THE

INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. Chairman, my name is Robert L. McCormick, Jr. I am First Vice President of the Independent Bankers Association of America and President/Chief Executive Officer of the Stillwater National Bank and Trust Company of Stillwater, Oklahoma.

IBAA represents over 7300 national and state chartered small and medium-size banks in 48 states and the District of Columbia. Most of our banks serve rural and suburban markets. Measured by asset size, most of our banks are small with more than 80 percent having assets of \$25 million or less. While banks of this size account for less than 10 percent of all commercial bank assets, they nevertheless supply most of the credit needs of households, farmers and small business in their respective communities. This is reflected in the relatively high proportion of their assets invested in loans to farmers. Approximately 40 percent of their assets are in agricultural loans compared to an industry average of only 3 percent. In addition, while the national average of loans to individuals is 13 percent of assets, our banks show an average of 17 percent.

We are pleased to appear before you today Mr. Chairman, to comment primarily on S. 1703, the Administration-developed bill which you introduced by request on October 5, and on S.1720, the Financial Institutions Restructuring and Services Act of 1981.

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At the end of our testimony we will briefly comment on S. 1721, which proposes the merger of the financial institutions insurance funds, and S. 1686, which was introduced by Senator Lugar and addresses reserve requirements and NOW accounts for state and local governments. S. 1720, as introduced by Chairman Garn, includes the major recommendations of the Administration and Federal Home Loan Bank Board Chairman Pratt for increasing the flexibility and authority of federal agencies in dealing with troubled savings and loan institutions.

We share the concern of the Federal regulatory agencies and this Committee over the problems facing some of our financial institutions, particularly savings and loan associations and mutual savings banks. However, we fear that a sweeping restructuring of the nation's financial industry is being pressed forward with greater haste than necessary under the debatable contention that the existing thrift crisis requires such drastic measures.

The emergency atmosphere created by conditions prevailing in some sectors of the financial industry has already prompted the adoption of a variety of remedial measures. These measures include the All Savers Act, expanded IRA/Keogh authorizations, the opening of the Fed discount window to the thrifts, authorization for new flexible interest rate

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mortgages, new accounting procedures looking towards helping thrifts dispose of low yielding mortgages, capital infusion devices, etc. And we are now rushing into the consideration of comprehensive new legislation before the effects of the previously adopted legislation and regulatory measures are known.

Before addressing some of the specific provisions of the four bills before this Committee, I must point out that, while the Independent Bankers Association is on record in support of some of these proposed changes and reiterates that support today, we are adamantly opposed to the Committee's adoption of such far-reaching changes in our Nation's financial structure in an omnibus package hurtling down a legislative fast track. S. 1720 contains seven Titles. Each of them is highly significant, has serious ramifications, and deserves to stand or fall on its own merits. To lump them together may increase the odds that a legislative package will emerge from this Committee; for the competing views of interest groups will inevitably tend to cancel one another out.

But it does not guarantee that the legislation which emerges will be either fundamentally sound or better meet the needs of our economy or of the consumer of financial services in our nation. Specifically, if an act of Congress

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begins the process of destroying the concept of specialized financial institutions such as the thrifts by according thrifts all commercial bank powers, who will finance the future housing needs of America? Supposedly, we are being forced to take this step by the force of circumstances--namely the critical financial situation of the thrift industry. Yet we have not heard any responsible person claim that this bill will help solve the short-term problems of the thrift industry. Fed Chairman Volcker has testified before the House Banking Committee that the issues joined in the Regan-Pratt bill (which are encompassed in Title I of S. 1720--that is, a basic restructuring of the thrift industry--are "not going to bear on the earnings and viability of those institutions" over the near term. And the American Banker reported on October 14 that Fed Vice Chairman Schultz told the National Savings and Loan League that thrift institutions would likely suffer severe loan losses if they were allowed to make commercial loans. Reportedly, the highly respected Fed Vice Chairman warned that such losses must be expected since thrifts lack the expertise to make such loans.

In short, this Association sees none of the kind of relief that thrifts now need coming from any of the bills before us today. Rather, we suggest attention be immediately turned to

the core of the problem: the thrifts' low-yielding mortgage portfolio does not generate enough income to prevent an immediate and serious deterioration of net worth during this high interest rate climate. A positive solution to meet this real problem must be devised quickly. The usual objection to all the proposals that the thrifts themselves have offered, ranging from the warehousing of low yielding mortgages to outright subsidization by the Federal government of such loans, is that it will cost Washington too much money in a time of austerity. These solutions have not had enough investigation to be rejected in an out-of-hand fashion. For instance, currently pending before this Committee is S. 984, introduced by Senators Moynihan and Heinz, providing for an "off-budget" swapping arrangement of low-yielding mortgages for variable rate, non negotiable notes of the FDIC and FSLIC, to be redeemed within three to ten years. This bill, and other suggested solutions to the low yielding mortgage problem, should receive quick and intense consideration from the Committee. Such solutions look towards maintaining thrifts as profitable specialized lending institutions which have played and must continue to play an indispensable role in meeting the housing needs of our nation.

Mr. Chairman and members of this distinguished Committee, we also would be remiss in our testimony if we did not express our dismay over the blueprint that Treasury Secretary Regan has drawn for the restructuring of our nation's financial industry in two major speeches on September 14 and 18. The major bills before you clearly begin to implement this comprehensive restructuring plan.

Secretary Regan's views on the need for a comprehensive overhaul of our nation's financial laws are well-known. Essentially they propose a great leap backward into the laissez-faire days of Coolidge and Hoover. He clearly wants to do away with the banking reform laws passed in the 1930's after the great crash. He wants to do away with specialized institutions. He wants to do away with interest rate regulation promptly even if it bankrupts additional thrifts. (It was only late last week after a crack U.S. League political assault division came to Washington, that the Secretary was deflected from this ill conceived course). He wants to abolish the separation of investment banking from commercial banking and do away with the prohibition against commercial bank participation in the securities business. He wants to combine Federal regulatory agency powers in Washington. And, yes, he wants to open the door to allow the financial giants to cross state lines and bid for local deposits in

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local communities without regard to state laws, the dual banking system, or where such siphoned funds will be ultimately utilized. This is against the backdrop of smaller banks having far higher capital requirements than do their big city banking counterparts....not to mention the legally non-existent capital and reserve requirements of Merrill Lynch. In his interview in Friday's Wall Street Journal, the Secretary suggested that these legislative proposals do not address interstate banking questions. It is our contention that these proposals directly challenge both the McFadden Act and the Douglas amendment, in addition to undermining countless state banking laws, by making thrifts which have far more liberal intra- and interstate branching rights into commercial banks.

The oft-stated prescriptions of the Treasury Secretary and the parallel prescriptions of the Justice Department inevitably will lead to significantly increased financial concentration and a dramatic reduction in the number of financial decision-making centers in our nation. We strongly oppose this economic and financial blueprint as contrary to the interests of our members and to the hundreds of thousands of consumers, small farmers, small businessmen and home owners which we serve. We believe the Secretary has overlooked the vital role credit unions, thrifts, realtors,

brokers, and insurance agents, have played in the past and should play in the future in providing services for the consumer of financial services.

With these caveats expressed, I will proceed to discuss the position of the Independent Bankers Association regarding some of the specific provisions of these bills.

Specific Comments on S. 1720 and S. 1703

Title I of S. 1720 and Title II of S. 1703 give thrifts almost all commercial bank investment and lending powers. They would permit federal thrifts to (1) issue overdraft loans with respect to any transactions account; (2) invest up to 100 percent of assets in loans secured by residential or nonresidential real property; (3) invest in each other's time and savings deposits; (4) invest up to 100 percent of assets in state or local obligations; (5) invest up to 100 percent of assets in secured or unsecured loans for commercial corporate, business or agricultural purposes; (6) invest up to 100 percent of assets in commercial paper and corporate debt securities; (7) invest in a wide variety of mutual funds; (8) invest in consumer loans including inventory and floor planning loans, equipment leasing, and educational loans.

It has been the consistent position of IBAA that further expansion of the lending and investment powers of thrift institutions would: (a) drastically curtail the flow of funds into housing by fostering a shift into short term assets; (b) push thrift institutions away from their field of specialization and into a full service commercial banking mode; and (c) create a dual set of rules governing commercial banks on the one hand and commercial banks operating under the guise of thrift chartered institutions on the other.

The original statutes creating thrifts as specialized institutions were an essential part of a national housing policy to broaden the base of home ownership and to provide adequate housing for the nation's families. Giving thrifts commercial banking powers can only aggravate the current crisis of the housing industry and make it more difficult for families to satisfy their urgent and growing housing needs.

The inevitable consequence of the proposed expansion of thrift powers will be to create a new type of commercial bank operating under a more advantageous regulatory structure than that which presently governs federal and state-chartered commercial banks. Thrift institutions have historically been granted special privileges in return for investing

primarily in mortgages, including tax advantages and the protection of Regulation Q with its differential. These titles, while granting thrifts asset powers approaching those of commercial banks, fail to remove the special privileges designed to induce them to specialize in mortgage lending. Further, evidence of the inequality of treatment commercial banks would encounter if these titles become law would be found in the difference in treatment of capital reserves. Thrift institutions are permitted to maintain relatively smaller capital reserves than commercial banks; approximately 50 percent below the reserves required for commercial banks.

These titles also open the door to interstate branching for thrifts by permitting thrifts (which meet the asset compositions test, imposed by subparagraph (c) of Section 7701(a)(19) of the Internal Revenue Code), to operate branches outside the state in which the thrift has its home office. Thrifts which gain the equivalent of commercial bank assets powers could, as we view this provision of the bill, branch across state lines while commercial banks would be prohibited from doing so under the McFadden Act.

Both bills, in their provisions dealing with bank and bank holding company takeovers of failing thrifts, track Section 8 of the House Banking Committee-passed Deposit

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Insurance Flexibility Act, and provide the FSLIC and FDIC with broad powers to merge and consolidate thrift institutions and commercial banks in severe financial straits. Under these provisions, the paramount consideration in authorizing such mergers and consolidations is the need to minimize the financial assistance required by the insurance agencies. By elevating the protections of the insurance fund to a position higher than other public interest considerations, this provision allows the regulators to permit interstate acquisitions of failing institutions without requiring exhaustion of potential intrastate solutions. We believe these provisions should be amended to give the highest priority to the intrastate options for like institutions including, if necessary, the breakup of threatened institutions too large to be assimilated by existing institutions of like kind in the same state. Cross-industry and interstate mergers and consolidations should have the approval of appropriate state authorities. This would both ensure that all public interest considerations are taken into account and give due deference to the state's prerogatives concerning the desired financial structure of that state.

We are confident that the federal insurance agencies, under present statutes, have the capability and resources to cope with the weakening or failure of a substantial number

of small thrift institutions without depleting their reserves. The primary justification for the emergency powers for bank takeovers of failing thrifts set forth in this bill is the potential threat created by the failure of a substantial number of very large institutions which might place a very severe drain on the resources of the insuring agencies. Therefore, any legislation dealing with this problem should focus on the remedies necessary to deal with the failure of the very large institutions. Similarly we are not aware of any major commercial bank of more than \$2 billion in assets which faces likely failure over the next twelve months, and thus strongly recommend that the breaching of the Douglas amendment be limited to bank holding company takeovers of failed mutual savings banks of more than \$2 billion in assets. In this regard we find it significant--and hope that the Committee does also--that the Administration bill, S. 1703, does not contain provisions permitting bank holding company takeovers of failed banks.

Furthermore, to avoid conflicts with state law regulating bank branching, any large thrift that might be acquired under the provisions of this bill by a bank or bank holding company should be made subject to the bank branching laws of the state in which its home office is located. This would

prevent the bank or bank holding company from gaining a competitive advantage over other banks or bank holding companies by acquiring a thrift institution with broader branching powers than those available to commercial banks. The House Banking Committee has accepted this amendment, which apparently enjoys regulator support. Similarly, the Congress should impress upon the regulators the importance of limiting financial concentration.

Additional Comments on Chairman Garn's
More Comprehensive Proposal, S. 1720.

In Title II of S. 1720, we endorse Section 201, which clarifies and liberalizes the statutory lending limits affecting national banks. Inflation has increased the size of loans required by many small businesses and farmers, necessitating the elevation of lending limits. The bill would raise the existing lending limit for a single borrower's unsecured loan from 10 percent to 15 percent of unimpaired capital surplus and provide for an additional 10 percent on loans secured by readily marketable collateral.

Inasmuch as there is an active movement on the part of independent banks to organize "bankers' banks," we find

Section 205 of Title II an important contribution to this movement which we support. It clarifies the authority of the Comptroller of the Currency to charter a "bankers' bank" and the authority of national banks to own stock in "bankers banks."

We also favor Section 211 of Title II, which would exempt financial institutions with deposits of \$5 million or less from the reserve requirements of the Monetary Control Act of 1980. However, we believe the exemption should be raised to include a broader category of small banks. The burden and costs of compliance outweigh the role these banks play in the conduct of monetary policy, and we urge that the exemption level be raised to relieve the small banks of this burden.

The amendments to FIRA in Part B of Title II are long overdue, and we believe they will overcome some existing legislative provisions which have been so troublesome to all commercial banks.

We also support Title III of S. 1720 which would permit national banks to deal in and underwrite revenue obligations issued or guaranteed by or on behalf of a state or any political subdivision thereof, if such obligations

S. 1721

With respect to S. 1721, which proposes to combine the insurance funds of the FDIC, FSLIC, and NCUSIF, we are in total opposition. The FDIC has the soundest base of all three corporations. Moreover, this foundation has been carefully nurtured and financed for over forty-eight years by commercial banker contributions that far exceed any stakes the Treasury or the Federal Reserve--both of which originally capitalized the Corporation--or any mutual savings banks--who have paid proportionately lower premiums than commercial banks--have in the FDIC. S. 1721 basically is a proposal to take banking's relatively healthy insurance pool and unload the problems of the thrift and credit union insurance funds into it. Any formula for merger that does not, in one way or another, (1) compensate commercial banks for their comparatively higher participation in the resulting, new fund or (2) realize fully that a joined FDIC/FSLIC/NCUSIF cannot place an unfair premium burden on commercial banks whose capital base would be the least risky of the insured institutions under the new fund, would be fatally deficient. S. 1721 does not meet either of these standards and, indeed, we frankly doubt any formula could be found which would.

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of state and local governments at financial institutions from the reserve requirements imposed by the 1980 Deregulation and Monetary Control Act; (2) conform certain technical provisions of this 1980 Act with the Federal Reserve Act, respecting NOW accounts; and (3) open NOW accounts to all state and local governments, whereas presently they are limited to educational and medical governmental entities. The overall purpose of the bill would be to increase income to states and municipalities.

The IBAA is very sensitive to the needs of non-federal governments, especially since they will now be carrying a larger burden for the provision of governmental services. However, we would hope that the Lugar bill would be laid aside for the present. Currently, as is well known, the Federal Reserve Board is struggling with a host of variables to establish a firm grip on measuring the money supply looking towards calming severe interest rate fluctuations. It would appear to us that either relieving state and local government deposits of reserve requirements or allowing such funds to flow into NOWs will be disruptive of this effort. We understand the Board will be running a number of computer analyses on the effects of this legislation and, after reviewing them, this Association's opinion might be prepared to comment more fully. But our estimate today is that this legislation may not be beneficial.

S. 1721

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S. 1721 presents another problem in which this Association has an intense interest. For many years, we have complained that the capital requirements of small banks have been kept at a punitively high level when compared to requirements imposed on larger banks. During a key speech to the American Bankers Convention on October 3, 1981, Quentin Thompson, Director of Bank Supervision of the FDIC, suggested an answer which we believe, from initial investigation, to be worthwhile--a variable FDIC insurance premium that allows well-capitalized and sound banks to pay less to the Corporation than riskier banks. We believe a merger of the FDIC/FSLIC/NCUSIF would thoroughly undermine any chance this solution has to address to the capital inequality problem.

In closing, Mr. Chairman, we appreciate that we have been invited to testify on these legislative proposals. It was not that long ago that we were testifying before this Committee to urge caution with respect to another major piece of legislation then pending before this Committee. That legislation looked towards giving the Federal Reserve the necessary tools with which to conduct a precise monetary policy and looked towards giving the thrifts new asset and liability powers designed to see them over the difficulties they were facing. That bill was signed into law on March 31, 1980, and is still being implemented. Against the backdrop of old panaceas that did not have their intended effect, we should approach the new panaceas being offered today with extreme caution. And we should be skeptical enough to realize that they may be part of a game plan looking to totally restructure the provision of financial services that will severely disadvantage many of the smaller providers of financial services and their millions of customers.

The Chairman. Let me make some general comments.

First of all, about this being hasty. In both of your testimonies, which is not really unexpected, we hear the same arguments, whether somebody is opposed or for it, they flip it one way or the other. We are either proceeding too rapidly or not rapidly enough, so there is no possibility of winning. But I quote the ABA statement. "There is no need to act on this legislation in a crisis atmosphere." Your testimony, "The sweeping restructuring of the financial industry is being pressed forward with greater urgency than necessary." And so forth.

The introduction of this legislation has nothing to do with the current problem of the thrifts. Give us credit for some intelligence that these changes would not take effect, as far as implementing them for a long time. Let's not use this as an old saw and an excuse. That is not the case. I don't know how many times I have stated before the ABA, IBAA and other groups, what my intentions were.

I have sat on this committee for 6 years. And I have watched the sputtering going back and forth with everyone very rarely coming to grips with any problems. We have been using band-aids, primarily because of the fact that most of the groups within the industry could not agree. They were fighting for their own self-interest, which is understandable. We do that in this society. But the intent of this legislation has nothing to do with the current crisis. But we are not that dumb. I reject that in your testimony as an excuse for not proceeding to consider this.

TESTIMONY RARELY CHANGES

So if that's what you want, if you want business as usual, I frankly am tired of hearing it both ways, the years that I have sat here, that you want something done. You want free enterprise. You want this power, and you want that power. But then when we propose something you don't like, we're moving too fast.

Now I don't know what you really want. If you want what has gone on all these years that I hear you bitch about over and over again every time I go to one of your meetings. How there is a lack of leadership in Congress; fine. Let's leave it that way. Let's not attempt to do anything. Let's make the usual charges that we are moving too fast for a crisis. I cannot more emphatically say that that is not the intent of this legislation. This Senator is bright enough to know that it will not do anything for the thrifts in the short run. But once in a while, maybe Congress ought to try to look 5 or 6 years down the road. That is the intent of this legislation, to try and anticipate for once rather than act defensively. Otherwise, the testimony very rarely changes.

The new president of the ABA will be back here. I've known them all for the last 6 years and 6 years into the future. We will be going through the dog and pony show over and over and over again. And maybe that is all we can do. Maybe that is all that is possible because of the selfishness and greed of individual parts of the industry. Maybe I'm just awfully dumb to think that it is possible to think ahead for once.

So don't come in here and say it is a rush and a crisis. We are trying to look down the road so that some president of the ABA or the Independent Bankers 5 years from now is not saying the same

thing, "Well, we got a problem. We have a rush here." or "You are not going too fast."

I cannot tell you how disappointed I am in the testimony of both of your organizations. All of you know what my intent is. You have heard it over and over again. We held extensive hearings this spring. It is not because I have any pride of authorship or that I necessarily agree with every provision of this legislation. I don't. I agree with some of your specific criticisms of it. The intent was to get it all out on the table and discuss it.

But once again, I see some testimony that is entirely, self-serving. "Let's look after our own and to hell with everybody else." In both your statements there is practically no mention of the real problem. That is the nonbanking type institutions interfering with your business. Hardly any mention.

ATTACK THE THRIFTS

I do not necessarily agree with all the things that we talk about giving to the thrifts. Your testimony is "attack the thrifts," 99 percent of it. "Attack the thrifts." I read it while you were testifying. If you want to guarantee that the legislation has no chance, and the thrifts come in and say "Don't give any of the new powers for the banks," then let's forget it. We are back into the old cycle.

Am I so naive, or is it possible sometime for people to look at the real problem? It sort of reminds me of the Arabs and the Israelis. They are so busy fighting, they cannot realize the real threat in the Middle East is the Soviet Union. And the changes that are occurring. Stick your head in the sand, and say, let's not have any changes whatsoever, while Merrill Lynch gobbles you up and Sears which has no geographical boundaries whatsoever puts all financial services in every store.

Gentlemen, I am sorry, but frankly, I really expected more. Now don't misunderstand me. I didn't expect you to agree with every phase of this legislation, to come in and give a blanket approval, but I expected a little more willingness to give and take and take a look at the problem, rather than just an attack on one segment of the industry. The savings and loans will come in with the opposite. So we will have no legislation. Have no legislation at all.

I really expected that you might address the real problem of needing some structural changes for the future, in order to combat that \$150 billion of money market funds. American Express, Sears, Prudential, and so forth. But if you want to maintain the status quo or get additional help for yourselves, but don't do anything for anybody else, then fine, if that's what you want, that's what you will get. So these new types of institutions grow and take over more and more of your business. In all of the statements I made this year, I thought I was protecting the security of people and trying to defend the depository institutions. It looks like my greatest problem in trying to get some changes to combat that new type of competition is from the very institutions I am trying to help.

I'm sorry. I guess I could just keep quiet and let everything go. But all of you know I have never been willing to do that.

In any event, my opinions are going to be well known in public and not hidden.

So I have used my questioning time to lecture you, but I just could not let it pass without saying I was disappointed in what I considered the self-serving nature of your testimony.

Senator Proxmire?

Senator PROXMIRE. Thank you, Mr. Chairman. The presentation by Mr. Jenkins, I think, is helpful in many respects. It's the first time I've seen this in testimony, and I think it is most useful that you have a table at the end. You go down each of the specific proposals, and you indicate your position, and you do it very specifically and expressly, and I welcome that. I am grateful to you for it.

I am also happy to see your emphasis right at the beginning of your statement, Mr. Jenkins, on the great importance not in this legislation, but nevertheless we are all aware of it, the great importance of a fiscal policy that is constructive and can bring interest rates down and get a grip on inflation. All of this legislation fits into that kind of economic framework we are in, and if we do not get inflation under control, and if we cannot begin to make some progress in this direction, whatever legislation we propose is not going to make much progress.

So I think you have been very helpful in that respect.

I feel a great respect for our chairman. I think he is a very bright man, as well as a very good man. I agree with him on a lot of things, but I think that last year we did make some real progress. We enacted a comprehensive bill to phase out regulation Q, to begin to phase it out. We provided an opportunity for the thrift institutions to broaden their powers to become more competitive. I think we set the stage for a more competitive national industry, and I commend both of you gentlemen who have testified this morning, Mr. Jenkins and Mr. McCormick, I think you have given us a notion of what we're up against up.

Mr. McCormick has indicated how important it is to him and to the Independent Bankers, as I understand it, to be concerned national concentration and to recognize the great value of local ownership. And I could not agree with him more.

Mr. Gunderson has reminded me of that often, and he, of course, is a former ABA head, and head of an excellent bank in a small town in Wisconsin. But local ownership is so unusually American. We are the only country in the world that has that, and I think that is one of the reasons we have the kind of productive and flexible and efficient financial system we have.

TAKEOVER AUTHORITY TEMPORARY

Mr. Jenkins, you say that the takeover authority granted in the legislation for interstate acquisitions and takeover of thrifts by bank holding companies would be temporary and could be terminated in no more than 2 years. What is your specific recommendation in this regard?

The Fed staff, as you know, takes the view that the Fed now has authority to permit bank holding company takeovers of thrifts. Should we make clear that after 2 years the Fed should not have such authority? At the end of 2 years should the Home Loan Bank Board not have the authority to approve interstate branching of thrifts?

Mr. JENKINS. We're talking about a specific piece of legislation to grant emergency powers. We are not talking about the Fed not having the power and retaining the powers they now have. There seems to be some legislation that would—I think they go 1 year, which is probably even better than 2 years. As an emergency measure, we consider this entire concept only in the emergency sense, and therefore, would allow things that might not normally be allowed during a 2-year or even a 1-year period. As you are pointing out, the Fed can do some of these things now. We do not say that the Fed should be disallowed from having that authority later on. That is not our point.

Senator PROXMIRE. Why do we need that provision?

Mr. JENKINS. The regulations say that they need emergency powers, and we do not object so long as there is a time limit.

Senator PROXMIRE. You're asking us to take another look at after 2 years; is that it?

Mr. JENKINS. That's the idea. It is a cautionary step more than anything else at this point.

Senator PROXMIRE. Mr. McCormick, you have a comment?

Mr. MCCORMICK. Yes, I would like to comment on that. Although the Fed takes the position that they have the power to do it, they have not done it in the past. I think their concern is that once they start approving the acquisition of thrifts by bank holding companies, they may lose their overall ability by regulation to just decline to do it for healthy thrifts. And so I think that it gives us an opportunity to limit the powers of holding companies in this area, which I believe is appropriate. And I think that the Fed would like to have this power limited, because they think that it might get away from them.

Senator PROXMIRE. Both and Mr. Jenkins appear to be in agreement that this legislation does not provide strong enough language to insure that all possibilities, intrastate acquisitions be exhausted before interstate acquisitions are permitted. Mr. Jenkins says after intrastate partners are exhausted the statute mandate partners in joining States. Do you agree with that?

Mr. MCCORMICK. No, I don't think that addresses the problem. The problem is that we are really paying a bribe to institutions to have the right to circumvent the laws of our Nation in buying a thrift institution or a failing financial institution by allowing them to cross State lines.

I do not think that is an appropriate way to run our country. The way that is set up, you go through a little litany of routines where you give everybody within the State an opportunity to bid on a failing institution. And then you have the out-of-State people come in and bid. And because of this opportunity to have this competitive advantage over everyone, the out-of-State folks are always willing to bid a little more money.

And so it is an exercise in futility.

Senator PROXMIRE. How would you safeguard that? How would you provide a situation where you do not have a Federal bailout and encourage settlement in the private sector as much as possible without encouraging cross-State acquisitions.

Mr. MCCORMICK. I think you could provide other provisions for possibly breaking up a failing institution and selling different parts

of it within the State. You could also have a provision that would put the public policy concerns raised by interstate branching ahead of simply how much money you're going to be able to raise in order to diminish your potential losses. We would like to submit to the committee some ideas on that later.

Senator PROXMIRE. We'd appreciate that.

Mr. Jenkins, Mr. McCormick says that since no \$2 billion commercial bank failure is on the horizon, that the takeover features of the bill be limited to thrifts and then only to mutual savings banks of over \$2 billion in size. Do you agree with that?

Mr. JENKINS. Well, if somebody's going to be hurt, they will be hurt whether they are big or small. And we accept this portion of S. 1720 as proposed.

Senator PROXMIRE. The idea of the size requirement—Mr. McCormick can speak for himself, but I take it that is if you have a reasonably small bank, that institutions within the State should be able to take care of it.

Mr. JENKINS. Should be able to.

Senator PROXMIRE. Mr. Jenkins, you say takeover authority granted in the legislation of interstate acquisitions and take over of thrifts by bank holding companies be temporary and terminate in no more than 2 years.

What is your specific recommendation in this regard? The Fed staff, as you know, takes the view that the Fed now has the authority to permit bank holding takeovers of thrifts. To make clear that after 2 years the Fed should not have that authority—I think I have asked that question. I apologize.

Mr. Jenkins, you say that the thrift powers in S. 1720 will do nothing about thrift earnings immediately, because it does nothing about the low-yielding mortgages held in the thrift portfolios.

Mr. JENKINS. Right.

Senator PROXMIRE. Secretary Regan made a very persuasive case for the thrift powers. His argument was that we need to do all we can to insure the long-range viability of thrifts. It is hard to imagine that anything other can be done than to give them much enhanced asset powers. And of course, that interferes with the commercial banks. After all, we do intend to deregulate the liability side of the portfolio. This bill would use takeovers and insurance funds to handle immediate severe thrift problems and give them powers to survive over the long term.

So if you oppose these powers for thrifts, what would you do?

Supposing you were sitting up here in Senator Garn's position and in my position, how would you handle this?

Mr. JENKINS. I can partially answer, if I may. The chairman's response to our testimony, we have a problem here that is one that has grown up over 25 years, and we are looking at it today as a real problem. These portfolios have—they are chock-a-block full of mortgages that do not have good rates on them. A lot of banks have the same kinds of portfolios, probably 10,000, 12,000 banks out there that have the same problem.

What we're thinking about here is that—and I must try to put this in my own context. I have to tell you what I understand—that the S. & L.'s have an immediate problem which has to be solved in an immediate way. They have got a future problem which has got

to be taken care of, we say, in another way. In all of the testimony that has been submitted, the points that we really want taken care of, Mr. Chairman, are submitted in that testimony. We agree that's what we want.

But the matter of the treatment of the thrift situation is an emergency matter. If they get into commercial lending right now, those of us who have been nothing but commercial lenders all of our lives have a pretty good realization—could be wrong but we have a pretty good realization that they are going to have trouble. To that extent, the trouble they might be in right now is going to be nothing as compared to the trouble they might be in.

Witness any new bank—

Senator PROXMIER. Could I interrupt? My time is up, but could I interrupt to say that you're right, they do have an immediate problem, we're all aware of that. And I think we want to do all we can to handle that. But they also have their long-term problem, and we would like to have you make any constructive suggestions you can make as to what they can do in the longer term.

CONTROLLED EXTENSION OF SPECIALIZED POWERS

Mr. JENKINS. I stated: "Nevertheless, we believe that controlled extension of specialized thrift institution powers could help solve their problems and deserves further study." That's true, but to do it now, this month or the next 5 months, could be hurtful to the thrifts. Making commercial loans is not an easy job. You cannot just step up and be called a commercial loan officer and do it.

This would put them in all kinds of difficulty. And as I say, far beyond the difficulty they could be in right now. They now have a loss that is attributable only to interest rates. You start getting losses based on bad loan judgment, the numbers get real big. And that is where our difficulty with it comes in. We are looking at this as realistic bankers who understand if the S. & L.'s get in trouble via this loan route, we are all in trouble, because very few people know the difference.

Mr. GUNDERSON. One of the problems, and we are not trying to be obstructive, as far as working with this committee in its attempt to resolve the problems of the thrifts, we have had about 1 week to look at the bill, particularly in the Pratt area. We have not been consulted by either the Federal Home Loan Bank Board or the administration on it, and as we state in our summary at the end, we are willing, and we pledge our commitment to work with this committee in allowing them to be more competitive; and certainly also to permit us to be more competitive. And we applaud the efforts of this committee in this area.

Moving ahead on the basis proposed in S. 1720 creates some great competitive inequities for the commercial banking system that we pointed out in our testimony, and we believe that this deserves study. We are willing to work with you, as we have said before. We are willing to compete. We are trying to reach that point where we can compete with not only the thrifts, but also the money market funds and others. And Mr. Chairman, we applaud you in this area. But we would end up on the short end of the deal if the Pratt proposal goes through unchanged, because you take a stock organization and try to compete with a mutual with all of the

other factors that are a part of it, and this is where we have a problem.

We are willing, and we will, work with you toward a long-run solution to the thrift problem..

Senator PROXMIRE. Thank you, Mr. Chairman. My time is up.

The CHAIRMAN. Senator Schmitt?

Senator SCHMITT. Thank you, Mr. Chairman.

Gentlemen, I am sorry that I missed your testimony. I have been scanning it. Do you really and truly believe that in the legislative goal and regulatory goal of having a level playing field for the financial institutions of this country?

Mr. JENKINS. Yes, we believe in a level playing field; surely.

Senator SCHMITT. Is that the consensus?

Mr. McCORMICK. We could endorse the concept, but we would like to add to that that we do think it is appropriate to have some regulation to assure that there are going to be a lot of players in this industry in the future, because of a lot of considerations in regard to the way our country is organized. There are some very powerful engines that push industries toward merger and consolidation, and those engines certainly exist in the financial services industry. We think most of the rules that we presently have to assure that we do not have such consolidation are good ones. We would like to find a way to allow those rules to change so that we can all be competitive and effective. But we do not want to throw the baby out with the bathwater.

Senator SCHMITT. You are saying that you want—you believe there ought to be a level playing field, but there are some parts of that field that some people can play in and some parts that other people can play in, and they do not necessarily intersect.

Mr. McCORMICK. I would not adopt that statement. I think I would say—

Senator SCHMITT. That's what I thought you said. I was using a different analogy. The chairman likes the analogy of the level playing field and it is a pretty good one.

Mr. McCORMICK. For one thing, I'm not sure how level the playing field really is. After all, when you look at what is going on, small banks operate with between 8 and 10 percent capital. The large banks of our country operate with 4 or 5. That requires small banks to try to reach for twice the gross margins on the business that they have in order to achieve the same kinds of returns on equity, and there are hundreds of other inequitable situations that exist.

Senator SCHMITT. All right. Now, I am getting you to move toward one of the points that I wanted to make, and that is we can talk about a level playing field, but can we realistically expect to have it? You just mentioned one variable, and that is size of institutions which conceptually means the field may tilt one way or the other, depending on size.

I mentioned, yesterday, to Secretary Regan that there may be some mounds, if not mountains, on that field caused by new tax law which has set interest rates in certain categories of investments, such as the all-savers category. There are loan guarantees that further distort the shape of the field, anyway. Low-interest loans have much the same effect; different insurance requirements,

differing reserve requirements, State charters versus national charters.

There is a unique situation that exists in Chafee's State contrasted to mine, and for the most part, the legislation we have discussed here does not address those kinds of variations in the topography of the playing field, does it?

Mr. McCORMICK. No; I do not think it does. Frankly, our association was not consulted with in regard to this legislation. We have had to rush through a consideration and take a position in this legislation—

Senator SCHMITT. I'm not asking you about that. I'm just trying to get, for my own mind, to the point of whether or not we still—this is *deja vu*, because I was asking these questions 4 years ago, 5 years ago when I first joined the banking committee; whether it is possible to really use the analogy of a level playing field. I mentioned the things that affect topology and topography on that field which are considerable. There are also differing goalposts. There are opportunities. The housing industry has certain requirements. The major construction industries have certain requirements. New plant construction and equipment, consumer services, operating loans, particularly for agriculture, and other businesses require operating loans. Retirement security now is an important part of the banking—or the financial community. So again, that tends to change the shape of things.

And what has bothered me ever since I started to get educated on this business, was where before we had some very specialized institutions dealing with specialized goals and problems of the American consumer and the American business community, we gradually got everybody trying to play in everybody else's sandbox without a level playing field, and maybe without the potential of ever having a level playing field. Are we really going after this in a philosophically consistent way with the way the financial institutions have developed and the kinds of needs that our consumers have?

Mr. McCORMICK. I think that your statement is very well taken. I wish I had said it. The thing that I guess bothers us is that, over all these years, we have created a lot of these regulations because we thought they benefited the public and because they achieved public policy goals that we believed were appropriate for our Nation; whether it be housing for folks or financing of agriculture, or to have a wide, diverse number of players in the marketplace making local decisions. And now we are saying in the quest for some sort of level playing field or some sort of commitment to a market theory, that the market solves all of our problems; that we are just going to throw it all open and let the fittest survive. That is the way to do it.

We do not believe that. We do not think it makes sense.

Senator SCHMITT. How do you handle the new teams that came on to this field in a sense with a different set of rules or no rules, such as the national financing networks that are being set up, as the chairman has mentioned, by Sears, Merrill-Lynch, and others? How do we handle that? Certainly there is very little inclination, at least I think on this committee, to add regulations to the financial game. We would like to eliminate it wherever we can.

Mr. JENKINS. The free market generally asserts itself, if you have what has amounted to a government-regulated free enterprise system, banking has a hodge-podge of rules and regulations on it. Most of us who have been in the game pretty seriously for a lot of years, and I have been in since December 1946, have realized for most of that term that what we are heading for in the financial services industry is some sort of a new tool and I think we're in the process of forging that tool right now. It will not be known as a commercial bank or a thrift, or as the things we talk of today. We probably will not get it very quickly either. The point is that we are getting in our minds, and this has gone on for at least a quarter of a century with some of us who learned to think back then about this sort of thing in the rookie days.

We are going into some sort of an instrument here, a tool to serve this country better in the financial services industry, and through getting that tool, we will then have a level playing field. In the process, like anything else in life, like a kid growing up, it will be "herkey jerkey" and we are going to make mistakes. We have already made a lot of them. We are trying to correct them. We are trying to do some of that now.

There are things we think we need. There are things that we think could be put off. We are going through a process. Yes, the mounds and the mountains that you speak of are sitting there. We are trying to get them leveled. We are not going to do it this week, but our aim is to get to what you are talking about, a level playing field.

We're looking for one-stop shopping. We see no reason why it should not happen. There are lots of folks who do, depending on what is going to happen. So we are in the process, just as you are, of trying to weed this thing out and come up with something that makes sense to you gentlemen, makes sense to us, and makes sense mostly to the general public. We are going to get there. We are just not there yet. We are striving for that level playing field.

Mr. GUNDERSON. It cannot happen overnight. We have to go through an orderly transition, because we have lived in a regulated environment for a good many years, and a lot of people have loans and investments in place that were put there during that regulated environment. But there needs to be an orderly transition, and this is one of the things that has frustrated us. As we look at the Pratt proposals and the S. & L.'s say that they want to be freed up to compete, and yet at every point in time, at every opportunity, they attempt to stymie and subvert the intent of Congress when you passed the omnibus banking bill here a short time ago to eventually phase out regulation Q, and to do away with the differential in deposit rate ceilings.

This is where we get into a problem with this. We recognize that it's going to take some time, and we will work to develop an orderly process. The chairman has gone a long way in the proposals before us, because if you will go through the list, we support virtually everything in there, with a couple of exceptions. But we do have a problem with the Pratt bill, because it would move in what we feel is an unfair and inappropriate way at this time.

We will work positively in the process to allow the thrifts to become more competitive.

Senator SCHMITT. Thank you, Mr. Chairman.

The CHAIRMAN. I would comment. I'm glad you said that. It is true; you go through the list, you go through your testimony, you get away from the rhetoric, and it is too bad in your testimony you could not have emphasized the parts you do support, the 95 per cent.

Mr. GUNDERSON. Mr. Chairman, I think you misinterpreted our statement, because our last paragraph does sum that up and indicate our willingness to cooperate and our intent to work with you. We are very sincere about that.

The CHAIRMAN. I am sure you are, Lee, but still the emphasis was on the internal warfare that has gone on forever between the thrift industry and the commercial banking industry. It might have been more helpful had you emphasized what you support, rather than such an overwhelming opposition to what you don't support.

Senator Dixon?

LIBERAL BRANCHING PRIVILEGES

Senator Dixon. Thank you, Mr. Chairman.

I wonder, Mr. Jenkins, if you would let me discuss with you a moment part of your testimony on page 5. In the last sentence of the paragraph you say:

For instance, specialized thrifts would enjoy more liberal branching privileges in many states than commercial banks offering the same financial services.

Now, I represent the State of Illinois. As you know, we do not have branch banking in Illinois. The last session of the legislature did liberalize our laws to some extent with respect to holding companies, but essentially we do presently have internally in our State a situation in which thrifts may branch and banks may not. Is that the type of thing you are referring to here?

Mr. JENKINS. That is exactly what it is about, yes. If you make commercial banks out of thrifts and let them stay under their present rules, instead of under the commercial bank rules, then you have two sets of commercial banks running in the same State, one of which can branch and the other cannot.

Senator DIXON. Without going into the merits of what has occurred in my State, and that is a dispute—it is a dispute that has continued for decades now in my State, I might say, it concerns me as a U.S. Senator to internally get involved in what has become the differentiation between the financial institutions in my State in such a way that we would create what you are referring to here. Did I hear someone, either yourself or someone else—I had to leave the room for a moment to talk to someone that came up from my office—did I hear someone suggest that there was an amendment suggested that would address this problem? Even though you are not in favor of title I, did I hear someone suggest there was an amendment that would address the problem of internal differences within a State?

Mr. McCORMICK. Yes. It was adopted by the House. It is an amendment that would require a thrift institution that was acquired by a bank holding company to have to conform to the branching laws of the State in which the thrift institution—the

bank branching laws of the State in which the thrift institution was residing. Now, it was in a little bit different context. That was in the area of having bank holding companies take over thrifts.

Senator DIXON. I might call the attention of the chair and other members of the committee to the fact that while my State is unique, I think, there may only be two or three States in the Union so situated. My State is a State in which thrifts can now branch and banks cannot, and I think that is a significant distinction that the Congress ought to recognize, so that if we do do anything in this area, we do not impose upon the State our will here at the Federal level.

I would suggest that something—it is something we ought to discuss further with respect to that particular part of the bill.

Mr. GUNDERSON. We are in accord with that.

Mr. McCORMICK. We all agree with that.

Senator DIXON. On page 4:

Faster elimination of longer-term rate ceilings affecting the short-term deposit instruments, competitive with money market funds, are needed. Any support Congress could give depository institutions on these issues would be welcome.

I take it that you do not think that the all savers certificate is a short-term deposit instrument competitive with money market funds?

Mr. JENKINS. It depends on your point of view on who has got the money. I always look to the fellow who has got the money. An all saver can mean something good to me and it may not mean anything good to me, but something that we can go into against the money market funds will look good to everybody. We just need a better instrument to compete.

Senator DIXON. I would be delighted to have anything you may have in the way of suggestions in that connection for consideration, at your convenience.

Mr. GUNDERSON. We have submitted at every meeting, to the DIDC, the proposal for approval of a shorter-term certificate that we could offer to our small savers and give them a chance to earn a realistic return. Unfortunately, it keeps getting passed off and passed off; and now it is on the agenda for the next meeting, and we are very discouraged by the role and the way the DIDC has reacted to our problems in the competitive world out there.

They have got us so confused that we do not know whether we are coming or going. One day they pass something; the next week they withdraw it. They are not giving us the kind of direction that we need to plan and position our institutions to be competitive.

Senator DIXON. Would one of you stop by my office at some time, at your convenience, to discuss that specific question?

Mr. GUNDERSON. Yes.

Senator DIXON. My last question. Following up on what Senator Proxmire had developed earlier, before his time ran out.

We have listened to the problems of the thrifts all year. I am sure that you agree with us that there are problems out there. We have addressed the problems to some extent, through regulation permitting variable mortgages and things of that time. We have addressed the problem—I think more successfully than some originally suspected—through the All Savers certificate.

The thrifts continue to come to us. And I think the evidence is clear that they still have problems—and they come to us and they suggest the limit of time in which certain numbers of them can exist, given the present problem in high interest rates, coupled with their low-yield portfolio. I suppose the final question then ought to be:

If you oppose, as others have indicated to you, what we are discussing here, do you have any suggestion for a possible alternative to the short term, other than what we have already done, given the fact that everybody agrees that there is a problem out there?

Mr. GUNDERSON. In the back of our testimony we list the moves that have been made to assist the thrifts—and they are considerable, as you indicated.

Senator DIXON. That's right.

Mr. GUNDERSON. Certainly the key to it, as we indicated in the opening of Mr. Jenkins' oral statement, is to restore economic stability in this Nation, and that is really going to solve many of the problems.

Senator DIXON. We would all agree with that.

Mr. GUNDERSON. We cannot get in an argument on that. And we are very much committed to supporting the efforts of Congress in this area. There may be other areas for the short-term assistance, but the Pratt proposal does nothing to address any of those.

It is not the case that we are opposing everything in here. We are opposing it in its present form, in the present way that it is being submitted. And if we come down a little strong on that, it is because we saw Secretary Regan come in here yesterday with the force of the administration behind his proposal. It has been around a very short time. And if we came down pretty heavy on it in our testimony, we figured we needed a big two by four in that particular area, because it looks like everybody is coming in with all of their guns blazing.

Senator DIXON. I suppose I take it from that that your ultimate response is: If rates come down substantially, we will not have the problem. We all agree with that.

The Secretary told me yesterday that the light at the end of the tunnel is not an approaching train—which I know gratified us.

But I wondered, on the short-term basis, given the fact that interest rates may not come down that much, and given the fact that what the Chair is suggesting in this bill is not suitable to your association, whether you see any other viable alternatives in the short term, other than what we have already seen?

Mr. GUNDERSON. Some of these are embodied in the proposed bill: Relaxation of usury and due on sale prohibitions which will help a great deal; the proposals for the regulators bill, which we basically have supported with a few caveats in there, and the Federal Home Loan Mortgage Corporation loan swap proposals. There are measures that are a part of this that we are very supportive of, and we believe that these will be in the best interest of the thrifts in particular, but certainly for all financial institutions in this Nation.

CONGRESS RESPONSIBLE FOR THRIFTS PROBLEMS

Mr. McCORMICK. Yes. I think most of the proposals are designed to help the thrift industry to cope with their problems. But I believe that our association feels very strongly that the thrift industry is in trouble, by and large, because they did what Congress had asked them to do, and followed the intent of Congress in making the kinds of loans that they made.

Senator DIXON. That's exactly the point, don't you know. They did what they were told to do, and now they are in trouble.

Mr. McCORMICK. Right. Our position is that we ought to recognize that they are in trouble, and we ought to take direct and appropriate action to address that, to save the industry, to maintain the industry for the purpose for which it was originally intended.

It looks to me and to us that there is almost a hidden agenda here, to avoid accepting the financial responsibility for the losses that are mounting, and trying in some way to pass that off to the banking industry, by going through sort of a convoluted process of converting them to commercial banks, and then selling them to bank holding companies.

We think that what you should do is accept responsibility for what took place. And if you have to appropriate funds to do it, so be it.

The CHAIRMAN. Mr. McCormick, you really want that kind of a bailout, in light of the budget problems we have got right now?

That is your solution to the thrifts' problem?

Mr. McCORMICK. Well—

The CHAIRMAN. Do you have any idea of the amount of money you're talking about?

Mr. McCORMICK. Yes. I do have an idea of the amount of money I'm talking about. It is not going to go away, Senator Garn. We can pass these laws and we can do these different things, but they do not address the problem. The problem stays.

If interest rates do not go down, the thrifts' loan portfolios—a couple of billion dollars under water. That is not going to change, based on what we have proposed here. It's still there.

The CHAIRMAN. Even if the interest rates go down, you have probably a \$60 billion deficit next year. I do not know how anybody in good conscience could propose that we add to that.

Mr. McCORMICK. I'm not proposing that we spend money that we have not already lost. The money is gone.

The CHAIRMAN. It is not gone from the Public Treasury.

Excuse me, Senator Dixon.

Senator DIXON. My time was up.

Mr. McCORMICK. The liability is there. It is in the insurance fund. It is our insurance fund.

The CHAIRMAN. You're talking about far beyond the insurance fund. There is not enough money in the insurance fund for a bailout. You're talking about direct appropriations, beyond that, from the Treasury.

Mr. JENKINS. We would have to go into every savings and loan in the country to prove what I am about to say. But the general feeling among many of us who have been in the lending game for a long time is that they probably are not in as deep a piece of trouble

as is indicated generally. We would not support—in the ABA, we would not support the idea of using Treasury funds to bail them out, if that is the right word. I hate that word.

The CHAIRMAN. I want to be careful in what I am saying.

Mr. JENKINS. I do, too.

The CHAIRMAN. I did not anticipate this at all. I think you are well aware that just in New York State alone, there are 10 mutual savings banks that are—if they went belly up—they are not going to, and that's why I want to be careful—they could wipe out the whole FDIC fund all by themselves, without any trouble at all. Just 10 of them.

Mr. McCORMICK. The all savers certificate was a use of public funds—it does not show up on the balance sheet—but just as surely it handed them the money. You cut the revenue of the IRS in order to cut their liability costs. We are just doing indirectly what we're not willing to do directly.

The CHAIRMAN. I do not totally agree with you there. Yes, it is a cut of Internal Revenue Service money, but I happen to believe in the philosophy that all of the money is ours. Internal Revenue and the Government take it away from us. Any amount that we can get back in reduced taxes, in one way or another, directly or indirectly, and put back in the hands of the American people to spend, I'm going to be for.

Senator Chafee?

Senator CHAFEE. Thank you, Mr. Chairman.

As I get it, the approach here, the suggestions of the members of the panel are that they favor this legislation. But the theme seems to be to go slow: Let's not deregulate too quickly; let's get adjusted; and in time, we will meet these problems.

Is that an unfair or a fair description of what you are proposing?

Mr. JENKINS. I think it is mixed. I think on most of it—and that which the Chairman addressed earlier, when he first spoke—we are for, rather rapidly. The more rapidly the better. We have already decided that at previous times.

On the Pratt proposal, the one we have emphasized—I am a new boy on the block, so I do not have all of the background, but I know what is going on generally—we see a danger. Not just a danger to us, but to the people for whom it would be done.

It would be a tough row for them to hoe if they were to use all of these powers real fast. We think they would be in trouble, and that one reason for going slow on that phase of this entire matter—only that phase.

SHOULD APPLY FOR COMMERCIAL BANK CHARTERS

Mr. McCORMICK. Our position is that on the thrift powers, if it is appropriate for thrifts to be commercial banks and to offer commercial bank services, that they should in fact apply for and get commercial bank charters. And if it is necessary to pass legislation to assist in bringing the thrift industry into the banking industry by in fact changing regulators, by getting a charter, by playing by all of the rules and regulations that we play by—if that is what must be done, then that is the way to do it. To create a completely new banking system, regulated by others, with completely different sets of rules, just adds to the craziness that we have now.

Senator CHAFEE. I get the point that you are making.

I must say in passing that one of the interesting things to me is that, as we review the deregulation we have brought about, we see the winners and the losers are not all as predicted.

I remember when we went into the airline deregulation, and people said, "The trunk carriers are going to be ones that prevail, and the little feeder airlines are going to suffer so badly." Well, the result has been the exact reverse of that.

So, all I am saying is that, I do not think that small banks should necessarily think that they are going to lose out in a general banking—whether it is branch banking, or interstate banking, or whatever it is. I think the small banks should have confidence in their ability to serve their customers. And they are not all going to be gobbled up by Chase Manhattan.

Perhaps that was not your testimony. But I just do not think small banks should think that they are necessarily going to go the way of the corner grocery store.

Let me ask you a question Mr. McCormick, dealing with an area that is of particular concern to me—namely the ability for banks, credit unions, and thrifts to set up and sell shares in commingled agency accounts. In other words, to get in the money market business—you take objection to the proposal of the administration regarding the holding company and a separate company handling that.

You say most small banks are not structured as holding companies. Well, maybe they are not. But what is the problem of being structured as a holding company?

It is not the most complicated legal maneuver ever undertaken.

Mr. McCORMICK. I understand. We see several problems with it:

First of all, once we get to a deregulated market as far as assets go, the ability to handle mutual funds—money market mutual funds—is not going to be that interesting to banks anyway. Because we will be able to compete head-up, in our own banks, as far as the terms, the convenience, and the rates go. That is something that we think is going to take place in the next 5 to 7 years, as we phase out of the regulation Q limitations that we presently have.

And so, this idea that we are all dying to get into the securities business—it is really a temporary effort, to try to compete until we can get to the point where we can get the nature of our assets changed enough so that we can afford the deregulated liabilities.

In addition to its temporary nature, we have the cost of converting to a holding company; and then we have the cost of organizing the investment company, complying with SEC regulations, and we pick up another regulator.

It seems to me that the banking regulators are completely competent to see that we comply with the laws of the land, and we do not need a new set of regulators, and have to create new corporations in order to give the service to our customers. It is just not necessary.

Mr. JENKINS. This was an idea put forth many years ago, incidentally, and it seems to be dredged up again. There is no real need to have this other layer in there. It is just not necessary. It is an added cost that goes against the grain of what we are in general trying to do. It simply brings up what—

I have the thing here. Treasury Under Secretary Roger Mehle first prepared this in a law review article published in 1975. It is the same idea put forth then, being brought up again now for reasons that escape us. But it simply puts another layer of cost in.

Senator CHAFEE. You mean to have the holding company?

Mr. JENKINS. To have the holding company, yes.

Senator CHAFEE. I get tangled up here in the argument you are making. One, you say you would not use it anyway, because it is going to go by the board.

Mr. McCORMICK. In the short term, we would have to do it. If we were to receive that kind of authorization, we would have to organize our holding companies, and we would have to organize the investment companies. We would have to get Fed approval. We would have to get SEC approval. And then we would have a new layer of regulators to work with, in order to offer essentially one new product in a bank, when we offer 20 or 30 products now.

And over a period of a few years, our need for all of that would be gone. Once you deregulate our liabilities, we can offer a competitive—

Senator CHAFEE. How would you do it?

Under the legislation I introduced, I did not require the holding company structure. I would just let you go ahead and issue them. But even under my bill, the operation of the fund itself would be regulated by the SEC. No one argues that.

Mr. McCORMICK. Yes.

Senator CHAFEE. You would take my proposal, which would not require the holding company setup. Is that right?

Mr. McCORMICK. I would suggest, as happens many times between regulators, that you would authorize the Comptroller of the Currency and the FDIC to handle the regulation side for the SEC, in providing this particular service to the public.

Senator CHAFEE. What about letting the credit unions and the thrifts deal with comingled agency accounts?

Mr. McCORMICK. I think they need to be able to compete, just the same as we do.

Senator CHAFEE. You know, the administration in its legislation would not permit the credit unions to get into it.

Mr. GUNDERSON. We feel, as does the IBAA, Senator, that we would support their ability to be competitive and offer these types of instruments, these types of investments. And we feel that your proposal is on the right track and is the appropriate one, rather than the holding company.

One thing people forget, we are not really talking about anything new. These are types of—just a different form of a type of service that has been traditional to banking. Banking has been in general obligation bonds for years. Now we are talking about revenue bonds.

We have been offering investment services to our customers for years. We have been doing it at my bank in Osceola without impairing the safety and the soundness of the banking system at all. We have been in all of these areas, investment advisory services, with our trust departments in other areas. So we cannot see any sense to have to create a new vehicle to do something we have been doing adequately for a good long time.

TAX TREATMENT DIFFERENCES

Senator CHAFEE. The Secretary yesterday was worried about the difference in the tax treatment that the banks would receive if you, in the revenue bond business——

Mr. GUNDERSON. There has been a lot of rhetoric about that. We have not seen any numbers or figures on that. We just do not feel that that is significant at all. You are talking maybe 2 or 3 days when you are carrying some of these items. We do not view that as a big deal at all. It is just a type of stumbling block, and I suspect his investment background was surfacing a little there. It has been around for a long time.

Senator CHAFEE. You are getting a lot of shots in at Mr. Regan's investment background, which I do not think it is quite appropriate here. I notice that you took a slam at him on page 15, "apparently does not want to support bank"——

Mr. GUNDERSON. We did not.

Senator CHAFEE [continuing]. "To compete with Merrill Lynch."

Mr. GUNDERSON. ABA did not. That is not in our testimony.

Senator CHAFEE. Mr. McCormick is guilty.

Mr. McCORMICK. We'll take credit for it. [Laughter.]

Senator CHAFEE. As far as I'm concerned, that is not the high point of your testimony.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Gentlemen, let's make an assumption here: That because of this internecine warfare that is typical and probably will not change while I am here, while we fight among ourselves, and assume that no legislation is produced, no new thrift powers, no additional powers for banks. And we end up with Ferdy St Germain's idea, that we produce the bare bones regulators' bills so that the sick ones can be merged with the other less sick ones. To see if we can solve the problem that way by putting Band-Aids on it. Then I would like to know how you propose to compete with Merrill Lynch, with Sears, American Express, all of them. They have no geographical restrictions, they operate anywhere they want—I still think that is the heart of the problem.

And again, despite your testimony, that is why I introduced this legislation. To try and get a level playing field as close as possible. I realize that is very difficult to do—between the depository institutions and the non. This whole hearing has been diverted, once again, into the fight between the thrifts and the commercial banks, instead of looking at what I consider your real competitive problems.

Now, is it possible to get some answers? Assuming all of this conflict kills any attempt to do anything and we just go with the bare bones legislation: Where are you going to be versus the money market funds and all of these new innovations that are now at over \$150 billion a year and growing rapidly, more rapidly than you can possibly get money into your institutions.

Mr. JENKINS. Mr. Chairman, please understand the only point we are making here is that we accept all of that, and it says so in our complete testimony. Under committee guidelines we are not allowed to read all of it. And you are right, we probably should have hit the positive more prominently in our brief oral statement.

But in this case we got rather excited about the negative aspect, which is the powers to the thrifts, because it would to hurt a lot of people. We do not think it is wise of us to approve a matter before Congress that will help a great deal but hurt somebody. And we would rather cut out the hurt. The Pratt proposal would be unfair to banks and could hurt savings and loans.

You asked what would happen if we did not get powers competitive with nondepository businesses. These fellows are eating our lunch, they have got their eye on our dinner.

If we cannot do things we want to do to compete with a mutual fund, the question really is not whether some banker wants to start a mutual fund or not, it is whether he has the privilege to start the mutual fund. Right now he does not have it. We want privileges to act. Not all banks need to do it, but we need to have the privilege.

Many of the provisions in S. 1720 would do a great deal toward helping depository institutions combat the efforts of the people who say they want to be the biggest financial services sector in the United States. Sears says they think banks will eventually become unfettered, and Sears wants to be miles down the road before that happens.

Mr. McCORMICK. If I may respond, Senator. First of all, I would like to say—I would like to emphasize that probably 80 percent of the sections and subjects presented in these titles, the American Bankers Association, Independent Bankers Association of America, are in agreement. So you do not have near the disagreements that you would have had in the past on a lot of this legislation.

There is a substantial movement on the part of both the associations in that area, but I would also want to say that this term deregulation is confusing—when one person talks about deregulation, he's talking about one thing; and when another talks about it, he is talking about another.

We can compete if we deregulate the asset side of our balance sheets. We can compete if you will let us provide competitive services and competitive products.

Now, there is some disagreement in regard to how fast we should do that. It is only because we are in a Catch-22. We have got a whole bunch of institutions trapped in the liability side with low-yielding—on the asset side with low-yielding assets. It is going to take a little time to work our way through that, and that is the reason why we think that a phaseout makes sense.

DEREGULATION NEEDED

But the deregulation that the banking industry needs and we are all on agreement on is to deregulate our ability to offer assets and liabilities so we can compete in the marketplace. Now that does not necessarily have anything to do with the structure laws of our country. The fact that we have got the thing organized so that we have thousands of providers of financial services, thousands of different locations primarily concerned about the local economies, it is just not involved.

And I do not see any evidence that the banking industry, as an industry, is severely injured because of the structure laws we have in this country. We are injured because of the interest rates laws

and a lot of the other laws that get in our way in providing services for consumers. We agree those need to be deregulated. We do not believe the other is applicable.

The CHAIRMAN. Mr. Jenkins, in your response to my question, you got back to the point that I really expected you to be making today, of where the real competition is. I think all of you know, particularly Lee—we have talked together enough the last year or so—he knows exactly where my feelings are. I have been out on a limb, sitting in this chair and making speeches all over this country about how grossly unfair it was for these nondepository institutions to be in the banking business and they come in and sit at that table and say they are not. They are.

The president of Sears is absolutely right, get a big head start.

Why I was so disappointed in your testimony was because rather than emphasizing your real problem—if I did not have any back-ground in it, I would be of the impression that the commercial banks of this country were scared to death of a crippled thrift institutions industry. Scared to death that giving them some additional powers was going to be something you could not handle in competition. Hardly a word about the Sears and the Merrill Lynchs, and so on. That is the impression I would have had from listening to your testimony cold, without knowing about it.

The point is if there is not within the depository institutions some consensus on these matters, you are not going to have any legislation. I cannot make that point strongly enough, and that is why I was so disappointed in your testimony again. If you depository institutions, thrifts, credit unions, cannot come to some consensus, there is nothing we can do up here. You will have no legislation. None of this will pass. You cannot pass part of the pieces of this puzzle. We cannot give you all of the authority you want to compete and tell the thrifts "Sorry. You must continue to struggle, you will get nothing."

I do not necessarily agree with all of the powers of the Federal Reserve. I want you to understand that. But from a practical point of view, point, you will not have a bill, and Sears is going to be a threat of you all. That is the problem that you gentlemen are facing, we cannot. If you fight among yourselves, I promise you there will be no legislation, not because I don't want it—but because of the realities of life. Anybody who has been around here for 10 years it took to finally produce H.R. 4986 knows that. In my third term, if I am still here and if the people of this country might come to some conclusion. That has been the case for 6, 7 years at a time.

Mr. GUNDERSON. I would hope you would give a sermon to the thrifts. I believe that we are going down the road moving toward deregulation and that we are frustrated every time we see that the thrifts throw up a roadblock that prevents a positive savings instrument.

We recognize that there is a need for change. We want to move ahead with the savings institutions into the thrifts, and they say no. We want to move ahead.

The CHAIRMAN. You know I call it as I see it, regardless of whom I'm talking to.

Mr. GUNDERSON. How well I do, Mr. Chairman.

The CHAIRMAN. You are aware that I suggested a faster phaseout of H.R. 4986, I've never understood regulation Q. I've never understood why the thrifts were so married to it. They would give away their wives, their children, their mothers to keep that quarter of a percent differential and let the whole world go to hell. How did they function before there was a regulation Q? They know my views very well on that subject.

What I am striving for is somehow to bring you people together, to come up with something that does the job. I do not want to preside over this committee 5 or 6 years down the road and have the few of you still left struggling to compete with retailers who are involved in the banking business without regulation.

I do not know how many times I have tried to make the point of what the intent of this entire legislation is, not a bailout of the thrifts. It was somehow to try and even up the playing field for the depository institutions against the new boys on the street. I do not condemn them for being innovative under the circumstances. That has been the American system. They are very bright to take advantage of a situation. But it is not fair to leave you all tied up.

Mr. JENKINS. Our problem today I think is you are the first person who has asked about this. This hearing is the first event that we have had relative to Mr. Pratt's proposal. But this matter came up, and nobody came to us and said "What do you think?" or "How else would you do it? Do you think we can get some middle ground, or what?"

The CHAIRMAN. And nobody asked the thrifts what they thought of municipal revenue bonds either. Everybody was treated equitably.

If we asked all of you what you thought, I would not have gotten around to introducing a bill of any kind to start the formal discussions, I guarantee you of that.

Gentlemen, excuse me. Senator Hayakawa is here and would like to make a statement. And my time is up in any event.

Sam, we are happy to have you here. We would be pleased to hear your statement at this time.

STATEMENT OF SENATOR HAYAKAWA

Senator HAYAKAWA. Thank you very much, Mr. Chairman.

I am here to testify in favor of section 302 of the Senate bill 1720. This section would allow banks, savings and loans, and credit unions to offer their customers collective fund service—most importantly, money market mutual funds.

Now, these institutions, including mutual savings banks and bank holding companies, would be authorized to sponsor investment companies and sell their shares. Such investment companies would be organized and registered in compliance with the Investment Company Act of 1940 and their shares registered under the Securities Act of 1933.

The Comptroller of the Currency with respect to banks, the Federal Home Loan Bank Board with respect to savings and loan associations, and the National Credit Union Administration Board

with respect to credit unions would, in consultation with the Financial Institutions Examination Council, set regulations governing the qualifications and practices of the officers and employees who sell shares of the fund.

The Securities and Exchange Commission would govern advertising and fees. The Comptroller of the Currency, the Federal Reserve Board, the Federal Depository Insurance Corporation, Federal Home Loan Bank Board, and the National Credit Union Administration Board would enforce the regulations for those institutions under their jurisdiction.

For those institutions that are not otherwise federally regulated, the Securities and Exchange Commission would enforce the regulations adopted by the appropriate agency.

Mr. Chairman, when we drafted the original legislation, we discussed many different ways of governing these activities. I believe this to be the best and the most efficient. The Federal financial regulatory agencies have the expertise and are the best equipped to deal with the institutions involved, and provide the best protection for their investors. Also, by retaining the regulatory and enforcement power of the funds at the Federal level, we can be assured of relatively uniform regulation. Mr. Chairman, these funds came into existence and they have prospered, because there is a need in the market for them.

PEOPLE CANNOT AFFORD THE COST OF SAVING

Most people would like to save, but have been unable to afford the cost. If they were to place their money in the normal passbook savings account, they would lose at least 4 percent every year, because of inflation. Certificates of deposit offered by depository institutions usually require a minimum investment of \$10,000, a sum beyond the reach of many.

And bank money market certificates, which do have a low minimum investment, are far less liquid and have lower yields. Money market funds, however, can be opened with as little as \$100, placing them well within the reach of almost everyone who wishes to save. They are also relatively liquid, and offer a higher yield than most bank investments.

Money market funds have given savers a much-needed alternative. The popularity of these funds is well known, Mr. Chairman, with current assets estimated at \$165 billion. And unless Congress legislates them out of existence, they will continue to grow. The only problem is that as the assets in these funds grow, assets in our existing financial systems are being depleted. The reason this is occurring is that Government will not allow the depository institutions to compete in a free market. So as we continue to restrict our financial institutions from offering these funds, the money normally used for business and home loans is disappearing. The provisions of Section 302 will allow depository institutions to offer a broader range of services with which to meet the needs of their depositors. Those banks, savings and loans, and credit unions whose size does not warrant the establishment of a fund are authorized to serve their customers by selling shares of another institution's fund, or any other already established fund.

The money an institution places in an existing fund could then be channeled back by agreement, into that institution's high-yield investment, thereby keeping the capital in the community. This capital can then eventually be used to support local business and housing needs; however, this is only an option, and not a requirement.

I feel it is important to point out, Mr. Chairman, the inclusion of credit unions in this legislation. If they had been excluded, they would have been placed at a distinct and unfair disadvantage in relation to all other financial institutions. They have suffered from the same competitive pressures as banks, and savings and loans, and should receive the same authority in this area. Before the legislation pertaining to section 302 was drafted, I read the bills which had been introduced in the House to authorize the Federal Reserve System to place reserve requirements and other types of restrictions on these funds.

It is said that by doing so the interest rates offered by money market funds would drop, making the already existing investment instruments of depository institutions competitive. Well, I am strongly opposed to that solution to this problem.

I do not believe it is the responsibility of the Government to make one business competitive by placing shackles on another. If we were to allow this to happen, we would be telling investors everywhere that the Government knows better than the free market what interest rates they should receive on their investment.

In March 1980, Mr. Chairman, Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980. One important provision of that act was the phaseout of regulation Q. Congress decided that the free market is the best judge of what the interest rates on savings deposits should be. I believe we must continue this philosophy and open up consultation in this area. That cannot be done by further Government regulation.

Further regulation would only harm small savers, and in the long run some other fund would come along to offer savers that which Government sought to take away—and once again, we would be before this committee discussing this same kind of issue. This section of S. 1720 will aid our financial institutions and the American people in their efforts to keep ahead of inflation. This is an important section, Mr. Chairman. I hope it will remain intact, without amendments, when S. 1720 is reported out of committee.

Thank you, Mr. Chairman. Mr. Chairman, let me announce that I will be glad to answer questions in writing if any are submitted. Right now, I have to be at another committee meeting.

The CHAIRMAN. I understand. Thank you very much, Senator Hayakawa.

Senator Schmitt?

Senator SCHMITT. Thank you, Mr. Chairman. Gentlemen, if I have distilled some of what you have said, would you agree that for banks and thrifts to compete with the "nondepository," institutions—Sears, et cetera—that what you need to have over some period of time is the removal of the anticompetitive effects of State lines and the anticompetitive effects of service restrictions?

Mr. GUNDERSON. We did not in our statement, Senator—

Senator SCHMITT. I am not talking about—that's been mentioned.

EVALUATING MCFADDEN-DOUGLAS ACT

Mr. GUNDERSON. The position of our association on McFadden-Douglas, to bring you up to date on this, is that when that legislation was passed, we supported it. At that time, the members of our association felt it was appropriate. Until our members—and we have a process through our leadership group of 400-and-some bankers, who are representative of a cross-section of banking, that address the key policy issues—until the bankers in the Nation tell us that they feel it is an appropriate time for any change whatever, our position remains in support of McFadden-Douglas. We are looking at it. It has been part of our leadership conferences. We are evaluating it.

But certainly, our big concern is our inability to offer competitive products and services. We will continue to review and analyze McFadden-Douglas as part of a look at the entire competitive environment in which we operate. But we have not come out with any position that says it is necessary for banking.

Senator SCHMITT. Your principal new competitors have no State line restrictions of any significance.

Mr. McCORMICK. Senator, I think basically the reason why it is difficult to understand is that we have 15,000 banks in the country. Almost every one of them is a local provider of financial services and almost every one of them is willing to continue to be a local provider.

Senator SCHMITT. I am going to get that. I am trying to get to the issue of your ability to compete with these nondepository institutions for whom State boundaries are transparent.

Mr. GUNDERSON. Essentially, there is a nationwide network of banking. I think that is what Mr. McCormick is saying. With these banks and all of their offices—we are also talking about the entire financial industry. There is a nationwide network of financial institutions out there right now.

Senator SCHMITT. So you feel for you to compete—we do not need for the banks to compete. We do not need to worry about State lines, State line restrictions. We need to worry about service restrictions.

Mr. GUNDERSON. Products and services are certainly the No. 1 priority. We are evaluating and looking at all of the other areas.

What our position will be in time—there are a lot of forces moving around out there—it is difficult to predict, Senator.

Senator SCHMITT. I take it from what has just been said that you want to be sure that you preserve the ability of the banking system of this country to offer that local customer service that up until now has been unique to the banks and thrift institutions—

Mr. McCORMICK. Yes; the essential local nature—

Senator SCHMITT. [continuing]. May also be encroached upon by these other financial entities.

Mr. McCORMICK. If we could offer the products—it is not a problem that we have competitors that are nationwide; if we could offer the products we could compete locally.

Mr. GUNDERSON. Unfortunately, the only side they are encroaching is the deposit side. They have not deemed it necessary to come

in and help us out on the loan side, and that is the problem the communities are facing and are going to be facing ever more so in the future.

Senator SCHMITT. In that respect, do you see that if some of these service and product restrictions were removed that we could preserve the local customer services and the categorical services that those customers desire to have?

Mr. McCORMICK. I cannot think of a service that we would not be able to offer in our local marketplace that could be offered on a nationwide basis. As far as data communications, computer power—you name it, it is all available to the local bank on a vendor basis. I do not think that we have to throw out the essential local nature of the banking system in order to allow the banking system to compete in a free market.

Senator SCHMITT. You do not think that it would occur naturally, if we removed the restrictions on products and services, that as you began to focus on competing with Sears or Montgomery Ward's, or Merrill Lynch or someone like that, would that start to occupy the attention of the banking community, rather than providing local service?

Mr. McCORMICK. I don't believe so.

Mr. JENKINS. That wouldn't happen.

Senator SCHMITT. What is the protection there? In New Mexico, we are very, very much a local-service-type environment.

Mr. JENKINS. We are saying there will always be a good community bank. If bank management is good now, it will be better if you let them do more for the community. We think that instead of having money go off into these nondepository institutions, as it is now doing to the tune of \$160 billion, the local bank, if given the right, would be able to hold those funds for a lot of reasons. Your state is a good one. Look at the allegiance that a person living in a city or a town in your State has to his local banker. If given the opportunity, he will deal with the local banker. We are saying let's give that local banker a chance to do what he has to do.

CORRESPONDENT BANKING

One of the things necessary to understand is that there is something called the correspondent banking service. It is essential to our system of banking. It can do all kinds of things. When asked to perform, it performs quickly and quite efficiently. This is an area of banking that a lot of people do not understand. But there is no reason why they should. It is there, it acts, it works. It does a lot of things for a local bank in New Mexico. This correspondent banking system is in existence now. We are just trying to get some more power for the local bankers so that the system can help them even more.

A fellow in a small bank offering a money market mutual fund might have a little difficulty. You don't just put it on the books and say, "There it goes." You have to have some people who do this. You have to have trained people. But a small bank can turn to his correspondent in Kansas City or Oklahoma City or wherever and say, "Here. Give me a hand with this." That kind of thing can go on, and would go on.

Mr. McCORMICK. I agree with that. I do not see—I am not concerned about Merrill Lynch's competition, or Sears' competition, if I can offer the same product. I think I can offer it more thoughtfully and more responsibly in my marketplace than they will. As a matter of fact, if I can offer the same product, there is very little motivation for them to try to come into my marketplace and market it, because I will be tough competition, and the members of my association will be tough competition.

Mr. JENKINS. There is a thing called "market leverage." Nobody, any kind of a manager, goes wading into somebody else's market when that person has market leverage. But if he can find a spot where the local manager does not have the thing we call "market leverage," he will wade in with both feet. And he will succeed. What we are saying is we need to get the market leverage spread throughout the system of depository institutions.

Senator SCHMITT. Mr. Chairman, I cannot help in this discussion have come to mind analogies between some of the situations that are being faced and are being created and those that we have recently faced in the Commerce Committee in dealing with telecommunications and common carrier reform, where if you consider money as a form of communications then there is a whole bunch of—a whole bunch of analogies that come to mind here—the only major difference being that the A.T. & T. has just suddenly appeared on the scene, rather than having been there since 1934. The potential A.T. & T. It may be that we can come—we can benefit from the experience of how we have finally, I think, put together the beginnings of a truly competitive telecommunications system, while still protecting those local exchanges, which are banks, and the services that they are supposed to be providing. I may take a little time to explore that analogy, and come back to you with some thoughts.

Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, first of all, in light of the discussion that has just occurred, let me assure everyone that overhaul of McFadden/Glass-Steagall is not in this bill. Preliminary discussion we had about State boundaries but we are simply not intending at all to look at that, at those broad issues or broad reviews, until next year.

Let me ask you one general question. You have been here a long time. I have a lot of detailed questions. I would like to submit them to you for response in writing, and I am sure other senators will, as well, on some of the technical questions in the bill.

But as we closed off before Senator Hayakawa was here, one of you said something about middle ground. I was trying to make that point very strongly. And you say, well, you have other alternatives for the thrifts. That is a general statement.

But what I want to know, and let's see if I can put you on the spot—Are you willing to work with the committee and with the thrift industry in trying to come up with some compromises that both industries can live with? Are you willing to sit down and attempt to work on some compromises, some middle ground, as one of you used the term—I do not remember which one. Otherwise what I said is true, we will not have a bill and the nondepositories will roll merrily along, taking all of your money away from you.

I have the thing here. Treasury Under Secretary Roger Mehle first prepared this in a law review article published in 1975. It is the same idea put forth then, being brought up again now for reasons that escape us. But it simply puts another layer of cost in.

Senator CHAFEE. You mean to have the holding company?

Mr. JENKINS. To have the holding company, yes.

Senator CHAFEE. I get tangled up here in the argument you are making. One, you say you would not use it anyway, because it is going to go by the board.

Mr. McCORMICK. In the short term, we would have to do it. If we were to receive that kind of authorization, we would have to organize our holding companies, and we would have to organize the investment companies. We would have to get Fed approval. We would have to get SEC approval. And then we would have a new layer of regulators to work with, in order to offer essentially one new product in a bank, when we offer 20 or 30 products now.

And over a period of a few years, our need for all of that would be gone. Once you deregulate our liabilities, we can offer a competitive—

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Mr. GUNDERSON. We feel, as does the IBAA, Senator, that we would support their ability to be competitive and offer these types of instruments, these types of investments. And we feel the proposal is on the right track and is the appropriate one, rather than the holding company.

One thing people forget, we are not really talking about anything new. These are types of—just a different form of a service that has been traditional to banking. Banking has been general obligation bonds for years. Now we are talking about new bonds.

We have been offering investment services to our customers for years. We have been doing it at my bank in Osceola without impairing the safety and the soundness of the banking system at all. We have been in all of these areas, investment advisory services, with our trust departments in other areas. So we cannot see any sense to have to create a new vehicle to do something we have been doing adequately for a good long time.

differing reserve requirements, State charters versus national charters.

There is a unique situation that exists in Chafee's State contrasted to mine, and for the most part, the legislation we have discussed here does not address those kinds of variations in the topography of the playing field, does it?

Mr. McCORMICK. No; I do not think it does. Frankly, our association was not consulted with in regard to this legislation. We have had to rush through a consideration and take a position in this legislation—

Senator SCHMITT. I'm not asking you about that. I'm just trying to get, for my own mind, to the point of whether or not we still—this is *deja vu*, because I was asking these questions 4 years ago, 5 years ago when I first joined the banking committee; whether it is possible to really use the analogy of a level playing field. I mentioned the things that affect topology and topography on that field which are considerable. There are also differing goalposts. There are opportunities. The housing industry has certain requirements. The major construction industries have certain requirements. New plant construction and equipment, consumer services, operating loans, particularly for agriculture, and other businesses require operating loans. Retirement security now is an important part of the banking—or the financial community. So again, that tends to change the shape of things.

And what has bothered me ever since I started to get educated on this business, was where before we had some very specialized institutions dealing with specialized goals and problems of the American consumer and the American business community, we gradually got everybody trying to play in everybody else's sandbox without a level playing field, and maybe without the potential of ever having a level playing field. Are we really going after this in a philosophically consistent way with the way the financial institutions have developed and the kinds of needs that our consumers have?

Mr. McCORMICK. I think that your statement is very well taken. I wish I had said it. The thing that I guess bothers us is that, over all these years, we have created a lot of these regulations because we thought they benefited the public and because they achieved public policy goals that we believed were appropriate for our Nation; whether it be housing for folks or financing of agriculture, or to have a wide, diverse number of players in the marketplace making local decisions. And now we are saying in the quest for some sort of level playing field or some sort of commitment to a market theory, that the market solves all of our problems; that we are just going to throw it all open and let the fittest survive. That is the way to do it.

We do not believe that. We do not think it makes sense.

Senator SCHMITT. How do you handle the new teams that came on to this field in a sense with a different set of rules or no rules, such as the national financing networks that are being set up, as the chairman has mentioned, by Sears, Merrill-Lynch, and others? How do we handle that? Certainly there is very little inclination, at least I think on this committee, to add regulations to the financial game. We would like to eliminate it wherever we can.

Mr. JENKINS. The free market generally asserts itself, if you have what has amounted to a government-regulated free enterprise system, banking has a hodge-podge of rules and regulations on it. Most of us who have been in the game pretty seriously for a lot of years, and I have been in since December 1946, have realized for most of that term that what we are heading for in the financial services industry is some sort of a new tool and I think we're in the process of forging that tool right now. It will not be known as a commercial bank or a thrift, or as the things we talk of today. We probably will not get it very quickly either. The point is that we are getting in our minds, and this has gone on for at least a quarter of a century with some of us who learned to think back then about this sort of thing in the rookie days.

We are going into some sort of an instrument here, a tool to serve this country better in the financial services industry, and through getting that tool, we will then have a level playing field. In the process, like anything else in life, like a kid growing up, it will be "herkey jerkey" and we are going to make mistakes. We have already made a lot of them. We are trying to correct them. We are trying to do some of that now.

There are things we think we need. There are things that we think could be put off. We are going through a process. Yes, the mounds and the mountains that you speak of are sitting there. We are trying to get them leveled. We are not going to do it this week, but our aim is to get to what you are talking about, a level playing field.

We're looking for one-stop shopping. We see no reason why it should not happen. There are lots of folks who do, depending on what is going to happen. So we are in the process, just as you are, of trying to weed this thing out and come up with something that makes sense to you gentlemen, makes sense to us, and makes sense mostly to the general public. We are going to get there. We are just not there yet. We are striving for that level playing field.

Mr. GUNDERSON. It cannot happen overnight. We have to go through an orderly transition, because we have lived in a regulated environment for a good many years, and a lot of people have loans and investments in place that were put there during that regulated environment. But there needs to be an orderly transition, and this is one of the things that has frustrated us. As we look at the Pratt proposals and the S. & L.'s say that they want to be freed up to compete, and yet at every point in time, at every opportunity, they attempt to stymie and subvert the intent of Congress when you passed the omnibus banking bill here a short time ago to eventually phase out regulation Q, and to do away with the differential in deposit rate ceilings.

This is where we get into a problem with this. We recognize that it's going to take some time, and we will work to develop an orderly process. The chairman has gone a long way in the proposals before us, because if you will go through the list, we support virtually everything in there, with a couple of exceptions. But we do have a problem with the Pratt bill, because it would move in what we feel is an unfair and inappropriate way at this time.

We will work positively in the process to allow the thrifts to become more competitive.

Senator SCHMITT. Thank you, Mr. Chairman.

The CHAIRMAN. I would comment. I'm glad you said that. It is true; you go through the list, you go through your testimony, you get away from the rhetoric, and it is too bad in your testimony you could not have emphasized the parts you do support, the 95 per cent.

Mr. GUNDERSON. Mr. Chairman, I think you misinterpreted our statement, because our last paragraph does sum that up and indicate our willingness to cooperate and our intent to work with you. We are very sincere about that.

The CHAIRMAN. I am sure you are, Lee, but still the emphasis was on the internal warfare that has gone on forever between the thrift industry and the commercial banking industry. It might have been more helpful had you emphasized what you support, rather than such an overwhelming opposition to what you don't support.

Senator Dixon?

LIBERAL BRANCHING PRIVILEGES

Senator Dixon. Thank you, Mr. Chairman.

I wonder, Mr. Jenkins, if you would let me discuss with you a moment part of your testimony on page 5. In the last sentence of the paragraph you say:

For instance, specialized thrifts would enjoy more liberal branching privileges in many states than commercial banks offering the same financial services.

Now, I represent the State of Illinois. As you know, we do not have branch banking in Illinois. The last session of the legislature did liberalize our laws to some extent with respect to holding companies, but essentially we do presently have internally in our State a situation in which thrifts may branch and banks may not. Is that the type of thing you are referring to here?

Mr. JENKINS. That is exactly what it is about, yes. If you make commercial banks out of thrifts and let them stay under their present rules, instead of under the commercial bank rules, then you have two sets of commercial banks running in the same State, one of which can branch and the other cannot.

Senator DIXON. Without going into the merits of what has occurred in my State, and that is a dispute—it is a dispute that has continued for decades now in my State, I might say, it concerns me as a U.S. Senator to internally get involved in what has become the differentiation between the financial institutions in my State in such a way that we would create what you are referring to here. Did I hear someone, either yourself or someone else—I had to leave the room for a moment to talk to someone that came up from my office—did I hear someone suggest that there was an amendment suggested that would address this problem? Even though you are not in favor of title I, did I hear someone suggest there was an amendment that would address the problem of internal differences within a State?

Mr. McCORMICK. Yes. It was adopted by the House. It is an amendment that would require a thrift institution that was acquired by a bank holding company to have to conform to the branching laws of the State in which the thrift institution—the

bank branching laws of the State in which the thrift institution was residing. Now, it was in a little bit different context. That was in the area of having bank holding companies take over thrifts.

Senator DIXON. I might call the attention of the chair and other members of the committee to the fact that while my State is unique, I think, there may only be two or three States in the Union so situated. My State is a State in which thrifts can now branch and banks cannot, and I think that is a significant distinction that the Congress ought to recognize, so that if we do do anything in this area, we do not impose upon the State our will here at the Federal level.

I would suggest that something—it is something we ought to discuss further with respect to that particular part of the bill.

Mr. GUNDERSON. We are in accord with that.

Mr. McCORMICK. We all agree with that.

Senator DIXON. On page 4:

Faster elimination of longer-term rate ceilings affecting the short-term deposit instruments, competitive with money market funds, are needed. Any support Congress could give depository institutions on these issues would be welcome.

I take it that you do not think that the all savers certificate is a short-term deposit instrument competitive with money market funds?

Mr. JENKINS. It depends on your point of view on who has got the money. I always look to the fellow who has got the money. An all saver can mean something good to me and it may not mean anything good to me, but something that we can go into against the money market funds will look good to everybody. We just need a better instrument to compete.

Senator DIXON. I would be delighted to have anything you may have in the way of suggestions in that connection for consideration, at your convenience.

Mr. GUNDERSON. We have submitted at every meeting, to the DIDC, the proposal for approval of a shorter-term certificate that we could offer to our small savers and give them a chance to earn a realistic return. Unfortunately, it keeps getting passed off and passed off; and now it is on the agenda for the next meeting, and we are very discouraged by the role and the way the DIDC has reacted to our problems in the competitive world out there.

They have got us so confused that we do not know whether we are coming or going. One day they pass something; the next week they withdraw it. They are not giving us the kind of direction that we need to plan and position our institutions to be competitive.

Senator DIXON. Would one of you stop by my office at some time, at your convenience, to discuss that specific question?

Mr. GUNDERSON. Yes.

Senator DIXON. My last question. Following up on what Senator Proxmire had developed earlier, before his time ran out.

We have listened to the problems of the thrifts all year. I am sure that you agree with us that there are problems out there. We have addressed the problems to some extent, through regulation permitting variable mortgages and things of that time. We have addressed the problem—I think more successfully than some originally suspected—through the All Savers certificate.

The thrifts continue to come to us. And I think the evidence is clear that they still have problems—and they come to us and they suggest the limit of time in which certain numbers of them can exist, given the present problem in high interest rates, coupled with their low-yield portfolio. I suppose the final question then ought to be:

If you oppose, as others have indicated to you, what we are discussing here, do you have any suggestion for a possible alternative to the short term, other than what we have already done, given the fact that everybody agrees that there is a problem out there?

Mr. GUNDERSON. In the back of our testimony we list the moves that have been made to assist the thrifts—and they are considerable, as you indicated.

Senator DIXON. That's right.

Mr. GUNDERSON. Certainly the key to it, as we indicated in the opening of Mr. Jenkins' oral statement, is to restore economic stability in this Nation, and that is really going to solve many of the problems.

Senator DIXON. We would all agree with that.

Mr. GUNDERSON. We cannot get in an argument on that. And we are very much committed to supporting the efforts of Congress in this area. There may be other areas for the short-term assistance, but the Pratt proposal does nothing to address any of those.

It is not the case that we are opposing everything in here. We are opposing it in its present form, in the present way that it is being submitted. And if we come down a little strong on that, it is because we saw Secretary Regan come in here yesterday with the force of the administration behind his proposal. It has been around a very short time. And if we came down pretty heavy on it in our testimony, we figured we needed a big two by four in that particular area, because it looks like everybody is coming in with all of their guns blazing.

Senator DIXON. I suppose I take it from that that your ultimate response is: If rates come down substantially, we will not have the problem. We all agree with that.

The Secretary told me yesterday that the light at the end of the tunnel is not an approaching train—which I know gratified us.

But I wondered, on the short-term basis, given the fact that interest rates may not come down that much, and given the fact that what the Chair is suggesting in this bill is not suitable to your association, whether you see any other viable alternatives in the short term, other than what we have already seen?

Mr. GUNDERSON. Some of these are embodied in the proposed bill: Relaxation of usury and due on sale prohibitions which will help a great deal; the proposals for the regulators bill, which we basically have supported with a few caveats in there, and the Federal Home Loan Mortgage Corporation loan swap proposals. There are measures that are a part of this that we are very supportive of, and we believe that these will be in the best interest of the thrifts in particular, but certainly for all financial institutions in this Nation.

CONGRESS RESPONSIBLE FOR THRIFTS PROBLEMS

Mr. McCORMICK. Yes. I think most of the proposals are designed to help the thrift industry to cope with their problems. But I believe that our association feels very strongly that the thrift industry is in trouble, by and large, because they did what Congress had asked them to do, and followed the intent of Congress in making the kinds of loans that they made.

Senator DIXON. That's exactly the point, don't you know. They did what they were told to do, and now they are in trouble.

Mr. McCORMICK. Right. Our position is that we ought to recognize that they are in trouble, and we ought to take direct and appropriate action to address that, to save the industry, to maintain the industry for the purpose for which it was originally intended.

It looks to me and to us that there is almost a hidden agenda here, to avoid accepting the financial responsibility for the losses that are mounting, and trying in some way to pass that off to the banking industry, by going through sort of a convoluted process of converting them to commercial banks, and then selling them to bank holding companies.

We think that what you should do is accept responsibility for what took place. And if you have to appropriate funds to do it, so be it.

The CHAIRMAN. Mr. McCormick, you really want that kind of a bailout, in light of the budget problems we have got right now? That is your solution to the thrifts' problem?

Mr. McCORMICK. Well—

The CHAIRMAN. Do you have any idea of the amount of money you're talking about?

Mr. McCORMICK. Yes. I do have an idea of the amount of money I'm talking about. It is not going to go away, Senator Garn. We can pass these laws and we can do these different things, but they do not address the problem. The problem stays.

If interest rates do not go down, the thrifts' loan portfolios—a couple of billion dollars under water. That is not going to change, based on what we have proposed here. It's still there.

The CHAIRMAN. Even if the interest rates go down, you have probably a \$60 billion deficit next year. I do not know how anybody in good conscience could propose that we add to that.

Mr. McCORMICK. I'm not proposing that we spend money that we have not already lost. The money is gone.

The CHAIRMAN. It is not gone from the Public Treasury.

Excuse me, Senator Dixon.

Senator DIXON. My time was up.

Mr. McCORMICK. The liability is there. It is in the insurance fund. It is our insurance fund.

The CHAIRMAN. You're talking about far beyond the insurance fund. There is not enough money in the insurance fund for a bailout. You're talking about direct appropriations, beyond that, from the Treasury.

Mr. JENKINS. We would have to go into every savings and loan in the country to prove what I am about to say. But the general feeling among many of us who have been in the lending game for a long time is that they probably are not in as deep a piece of trouble

I have the thing here. Treasury Under Secretary Roger Mehle first prepared this in a law review article published in 1975. It is the same idea put forth then, being brought up again now for reasons that escape us. But it simply puts another layer of cost in.

Senator CHAFEE. You mean to have the holding company?

Mr. JENKINS. To have the holding company, yes.

Senator CHAFEE. I get tangled up here in the argument you are making. One, you say you would not use it anyway, because it is going to go by the board.

Mr. McCORMICK. In the short term, we would have to do it. If we were to receive that kind of authorization, we would have to organize our holding companies, and we would have to organize the investment companies. We would have to get Fed approval. We would have to get SEC approval. And then we would have a new layer of regulators to work with, in order to offer essentially one new product in a bank, when we offer 20 or 30 products now.

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Mr. GUNDERSON. We feel, as does the IBAA, Senator, that we would support their ability to be competitive and offer these types of instruments, these types of investments. And we feel that your proposal is on the right track and is the appropriate one, rather than the holding company.

One thing people forget, we are not really talking about anything new. These are types of—just a different form of a type of service that has been traditional to banking. Banking has been in general obligation bonds for years. Now we are talking about revenue bonds.

We have been offering investment services to our customers for years. We have been doing it at my bank in Osceola without impairing the safety and the soundness of the banking system at all. We have been in all of these areas, investment advisory services, with our trust departments in other areas. So we cannot see any sense to have to create a new vehicle to do something we have been doing adequately for a good long time.

Senator CHAFEE. I get the point that you are making.

I must say in passing that one of the interesting things to me is that, as we review the deregulation we have brought about, we see the winners and the losers are not all as predicted.

I remember when we went into the airline deregulation, and people said, "The trunk carriers are going to be ones that prevail, and the little feeder airlines are going to suffer so badly." Well, the result has been the exact reverse of that.

So, all I am saying is that, I do not think that small banks should necessarily think that they are going to lose out in a general banking—whether it is branch banking, or interstate banking, or whatever it is. I think the small banks should have confidence in their ability to serve their customers. And they are not all going to be gobbled up by Chase Manhattan.

Perhaps that was not your testimony. But I just do not think small banks should think that they are necessarily going to go the way of the corner grocery store.

Let me ask you a question Mr. McCormick, dealing with an area that is of particular concern to me—namely the ability for banks, credit unions, and thrifts to set up and sell shares in commingled agency accounts. In other words, to get in the money market business—you take objection to the proposal of the administration regarding the holding company and a separate company handling that.

You say most small banks are not structured as holding companies. Well, maybe they are not. But what is the problem of being structured as a holding company?

It is not the most complicated legal maneuver ever undertaken.

Mr. McCORMICK. I understand. We see several problems with it:

First of all, once we get to a deregulated market as far as assets go, the ability to handle mutual funds—money market mutual funds—is not going to be that interesting to banks anyway. Because we will be able to compete head-up, in our own banks, as far as the terms, the convenience, and the rates go. That is something that we think is going to take place in the next 5 to 7 years, as we phase out of the regulation Q limitations that we presently have.

And so, this idea that we are all dying to get into the securities business—it is really a temporary effort, to try to compete until we can get to the point where we can get the nature of our assets changed enough so that we can afford the deregulated liabilities.

In addition to its temporary nature, we have the cost of converting to a holding company; and then we have the cost of organizing the investment company, complying with SEC regulations, and we pick up another regulator.

It seems to me that the banking regulators are completely competent to see that we comply with the laws of the land, and we do not need a new set of regulators, and have to create new corporations in order to give the service to our customers. It is just not necessary.

Mr. JENKINS. This was an idea put forth many years ago, incidentally, and it seems to be dredged up again. There is no real need to have this other layer in there. It is just not necessary. It is an added cost that goes against the grain of what we are in general trying to do. It simply brings up what—

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Mr. GUNDERSON. We feel, as does the IBAA, Senator, that we would support their ability to be competitive and offer these types of instruments, these types of investments. And we feel that your proposal is on the right track and is the appropriate one, rather than the holding company.

One thing people forget, we are not really talking about anything new. These are types of—just a different form of a type of service that has been traditional to banking. Banking has been in general obligation bonds for years. Now we are talking about revenue bonds.

We have been offering investment services to our customers for years. We have been doing it at my bank in Osceola without impairing the safety and the soundness of the banking system at all. We have been in all of these areas, investment advisory services, with our trust departments in other areas. So we cannot see any sense to have to create a new vehicle to do something we have been doing adequately for a good long time.

TAX TREATMENT DIFFERENCES

Senator CHAFEE. The Secretary yesterday was worried about the difference in the tax treatment that the banks would receive if you, in the revenue bond business——

Mr. GUNDERSON. There has been a lot of rhetoric about that. We have not seen any numbers or figures on that. We just do not feel that that is significant at all. You are talking maybe 2 or 3 days when you are carrying some of these items. We do not view that as a big deal at all. It is just a type of stumbling block, and I suspect his investment background was surfacing a little there. It has been around for a long time.

Senator CHAFEE. You are getting a lot of shots in at Mr. Rogan's investment background, which I do not think it is quite appropriate here. I notice that you took a slam at him on page 15, "apparently does not want to support bank"——

Mr. GUNDERSON. We did not.

Senator CHAFEE [continuing]. "To compete with Merrill Lynch."

Mr. GUNDERSON. ABA did not. That is not in our testimony.

Senator CHAFEE. Mr. McCormick is guilty.

Mr. MCCORMICK. We'll take credit for it. [Laughter.]

Senator CHAFEE. As far as I'm concerned, that is not the high point of your testimony.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Gentlemen, let's make an assumption here: That because of this internecine warfare that is typical and probably will not change while I am here, while we fight among ourselves, and assume that no legislation is produced, no new thrift powers, no additional powers for banks. And we end up with Ferdy St Germain's idea, that we produce the bare bones regulators' bills so that the sick ones can be merged with the other less sick ones. To see if we can solve the problem that way by putting Band-Aids on it. Then I would like to know how you propose to compete with Merrill Lynch, with Sears, American Express, all of them. They have no geographical restrictions, they operate anywhere they want—I still think that is the heart of the problem.

And again, despite your testimony, that is why I introduced this legislation. To try and get a level playing field as close as possible. I realize that is very difficult to do—between the depository institutions and the non. This whole hearing has been diverted, once again, into the fight between the thrifts and the commercial banks, instead of looking at what I consider your real competitive problems.

Now, is it possible to get some answers? Assuming all of this conflict kills any attempt to do anything and we just go with the bare bones legislation: Where are you going to be versus the money market funds and all of these new innovations that are now at over \$150 billion a year and growing rapidly, more rapidly than you can possibly get money into your institutions.

Mr. JENKINS. Mr. Chairman, please understand the only point we are making here is that we accept all of that, and it says so in our complete testimony. Under committee guidelines we are not allowed to read all of it. And you are right, we probably should have hit the positive more prominently in our brief oral statement.

But in this case we got rather excited about the negative aspect, which is the powers to the thrifts, because it would hurt a lot of people. We do not think it is wise of us to approve a matter before Congress that will help a great deal but hurt somebody. And we would rather cut out the hurt. The Pratt proposal would be unfair to banks and could hurt savings and loans.

You asked what would happen if we did not get powers competitive with nondepository businesses. These fellows are eating our lunch, they have got their eye on our dinner.

If we cannot do things we want to do to compete with a mutual fund, the question really is not whether some banker wants to start a mutual fund or not, it is whether he has the privilege to start the mutual fund. Right now he does not have it. We want privileges to act. Not all banks need to do it, but we need to have the privilege.

Many of the provisions in S. 1720 would do a great deal toward helping depository institutions combat the efforts of the people who say they want to be the biggest financial services sector in the United States. Sears says they think banks will eventually become unfettered, and Sears wants to be miles down the road before that happens.

Mr. McCORMICK. If I may respond, Senator. First of all, I would like to say—I would like to emphasize that probably 80 percent of the sections and subjects presented in these titles, the American Bankers Association, Independent Bankers Association of America, are in agreement. So you do not have near the disagreements that you would have had in the past on a lot of this legislation.

There is a substantial movement on the part of both the associations in that area, but I would also want to say that this term deregulation is confusing—when one person talks about deregulation, he's talking about one thing; and when another talks about it, he is talking about another.

We can compete if we deregulate the asset side of our balance sheets. We can compete if you will let us provide competitive services and competitive products.

Now, there is some disagreement in regard to how fast we should do that. It is only because we are in a Catch-22. We have got a whole bunch of institutions trapped in the liability side with low-yielding—on the asset side with low-yielding assets. It is going to take a little time to work our way through that, and that is the reason why we think that a phaseout makes sense.

DEREGULATION NEEDED

But the deregulation that the banking industry needs and we are all on agreement on is to deregulate our ability to offer assets and liabilities so we can compete in the marketplace. Now that does not necessarily have anything to do with the structure laws of our country. The fact that we have got the thing organized so that we have thousands of providers of financial services, thousands of different locations primarily concerned about the local economies, it is just not involved.

And I do not see any evidence that the banking industry, as an industry, is severely injured because of the structure laws we have in this country. We are injured because of the interest rates laws

and a lot of the other laws that get in our way in providing services for consumers. We agree those need to be deregulated. We do not believe the other is applicable.

The CHAIRMAN. Mr. Jenkins, in your response to my question, you got back to the point that I really expected you to be making today, of where the real competition is. I think all of you know, particularly Lee—we have talked together enough the last year or so—he knows exactly where my feelings are. I have been out on a limb, sitting in this chair and making speeches all over this country about how grossly unfair it was for these nondepository institutions to be in the banking business and they come in and sit at that table and say they are not. They are.

The president of Sears is absolutely right, get a big head start.

Why I was so disappointed in your testimony was because rather than emphasizing your real problem—if I did not have any background in it, I would be of the impression that the commercial banks of this country were scared to death of a crippled thrift institutions industry. Scared to death that giving them some additional powers was going to be something you could not handle in competition. Hardly a word about the Sears and the Merrill Lynches, and so on. That is the impression I would have had from listening to your testimony cold, without knowing about it.

The point is if there is not within the depository institutions some consensus on these matters, you are not going to have any legislation. I cannot make that point strongly enough, and that is why I was so disappointed in your testimony again. If you depository institutions, thrifts, credit unions, cannot come to some consensus, there is nothing we can do up here. You will have no legislation. None of this will pass. You cannot pass part of the pieces of this puzzle. We cannot give you all of the authorities you want to compete and tell the thrifts "Sorry. You must continue to struggle, you will get nothing."

I do not necessarily agree with all of the powers of the Pratt bill. I want you to understand that. But from a practical political standpoint, you will not have a bill, and Sears is going to be years ahead of you all. That is the problem that you gentlemen can solve and we cannot. If you fight among yourselves, I promise you there will be no legislation, not because I don't want it—I am telling you the realities of life. Anybody who has been around this body in the years it took to finally produce H.R. 4986 knows that. Maybe in my third term, if I am still here and if the people of Utah want me, we might come to some conclusion. That has been the usual pattern, 5, 6, 7 years at a time.

Mr. GUNDERSON. I would hope you would preach this same sermon to the thrifts. I believe that we have gone a lot further down the road moving toward deregulation than they have. And we are frustrated every time we see DIDC start to move that the thrifts throw up a roadblock that prohibits approval of a competitive savings instrument.

We recognize that there is a need for new products and services. We want to move ahead with them. Every time we do, we bump into the thrifts, and they say no, we cannot do this, we cannot move ahead.

The CHAIRMAN. You know I call it as I see it, regardless of whom I'm talking to.

Mr. GUNDERSON. How well I do, Mr. Chairman.

The CHAIRMAN. You are aware that I suggested a faster phaseout of H.R. 4986, I've never understood regulation Q. I've never understood why the thrifts were so married to it. They would give away their wives, their children, their mothers to keep that quarter of a percent differential and let the whole world go to hell. How did they function before there was a regulation Q? They know my views very well on that subject.

What I am striving for is somehow to bring you people together, to come up with something that does the job. I do not want to preside over this committee 5 or 6 years down the road and have the few of you still left struggling to compete with retailers who are involved in the banking business without regulation.

I do not know how many times I have tried to make the point of what the intent of this entire legislation is, not a bailout of the thrifts. It was somehow to try and even up the playing field for the depository institutions against the new boys on the street. I do not condemn them for being innovative under the circumstances. That has been the American system. They are very bright to take advantage of a situation. But it is not fair to leave you all tied up.

Mr. JENKINS. Our problem today I think is you are the first person who has asked about this. This hearing is the first event that we have had relative to Mr. Pratt's proposal. But this matter came up, and nobody came to us and said "What do you think?" or "How else would you do it? Do you think we can get some middle ground, or what?"

The CHAIRMAN. And nobody asked the thrifts what they thought of municipal revenue bonds either. Everybody was treated equitably.

If we asked all of you what you thought, I would not have gotten around to introducing a bill of any kind to start the formal discussions, I guarantee you of that.

Gentlemen, excuse me. Senator Hayakawa is here and would like to make a statement. And my time is up in any event.

Sam, we are happy to have you here. We would be pleased to hear your statement at this time.

STATEMENT OF SENATOR HAYAKAWA

Senator HAYAKAWA. Thank you very much, Mr. Chairman.

I am here to testify in favor of section 302 of the Senate bill 1720. This section would allow banks, savings and loans, and credit unions to offer their customers collective fund service—most importantly, money market mutual funds.

Now, these institutions, including mutual savings banks and bank holding companies, would be authorized to sponsor investment companies and sell their shares. Such investment companies would be organized and registered in compliance with the Investment Company Act of 1940 and their shares registered under the Securities Act of 1933.

The Comptroller of the Currency with respect to banks, the Federal Home Loan Bank Board with respect to savings and loan associations, and the National Credit Union Administration Board

with respect to credit unions would, in consultation with the Financial Institutions Examination Council, set regulations governing the qualifications and practices of the officers and employees who sell shares of the fund.

The Securities and Exchange Commission would govern advertising and fees. The Comptroller of the Currency, the Federal Reserve Board, the Federal Depository Insurance Corporation, Federal Home Loan Bank Board, and the National Credit Union Administration Board would enforce the regulations for those institutions under their jurisdiction.

For those institutions that are not otherwise federally regulated, the Securities and Exchange Commission would enforce the regulations adopted by the appropriate agency.

Mr. Chairman, when we drafted the original legislation, we discussed many different ways of governing these activities. I believe this to be the best and the most efficient. The Federal financial regulatory agencies have the expertise and are the best equipped to deal with the institutions involved, and provide the best protection for their investors. Also, by retaining the regulatory and enforcement power of the funds at the Federal level, we can be assured of relatively uniform regulation. Mr. Chairman, these funds came into existence and they have prospered, because there is a need in the market for them.

PEOPLE CANNOT AFFORD THE COST OF SAVING

Most people would like to save, but have been unable to afford the cost. If they were to place their money in the normal passbook savings account, they would lose at least 4 percent every year, because of inflation. Certificates of deposit offered by depository institutions usually require a minimum investment of \$10,000, a sum beyond the reach of many.

And bank money market certificates, which do have a low minimum investment, are far less liquid and have lower yields. Money market funds, however, can be opened with as little as \$100, placing them well within the reach of almost everyone who wishes to save. They are also relatively liquid, and offer a higher yield than most bank investments.

Money market funds have given savers a much-needed alternative. The popularity of these funds is well known, Mr. Chairman, with current assets estimated at \$165 billion. And unless Congress legislates them out of existence, they will continue to grow. The only problem is that as the assets in these funds grow, assets in our existing financial systems are being depleted. The reason this is occurring is that Government will not allow the depository institutions to compete in a free market. So as we continue to restrict our financial institutions from offering these funds, the money normally used for business and home loans is disappearing. The provisions of Section 302 will allow depository institutions to offer a broader range of services with which to meet the needs of their depositors. Those banks, savings and loans, and credit unions whose size does not warrant the establishment of a fund are authorized to serve their customers by selling shares of another institution's fund, or any other already established fund.

The money an institution places in an existing fund could then be channeled back by agreement, into that institution's high-yield investment, thereby keeping the capital in the community. This capital can then eventually be used to support local business and housing needs; however, this is only an option, and not a requirement.

I feel it is important to point out, Mr. Chairman, the inclusion of credit unions in this legislation. If they had been excluded, they would have been placed at a distinct and unfair disadvantage in relation to all other financial institutions. They have suffered from the same competitive pressures as banks, and savings and loans, and should receive the same authority in this area. Before the legislation pertaining to section 302 was drafted, I read the bills which had been introduced in the House to authorize the Federal Reserve System to place reserve requirements and other types of restrictions on these funds.

It is said that by doing so the interest rates offered by money market funds would drop, making the already existing investment instruments of depository institutions competitive. Well, I am strongly opposed to that solution to this problem.

I do not believe it is the responsibility of the Government to make one business competitive by placing shackles on another. If we were to allow this to happen, we would be telling investors everywhere that the Government knows better than the free market what interest rates they should receive on their investment.

In March 1980, Mr. Chairman, Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980. One important provision of that act was the phaseout of regulation Q. Congress decided that the free market is the best judge of what the interest rates on savings deposits should be. I believe we must continue this philosophy and open up consultation in this area. That cannot be done by further Government regulation.

Further regulation would only harm small savers, and in the long run some other fund would come along to offer savers that which Government sought to take away—and once again, we would be before this committee discussing this same kind of issue. This section of S. 1720 will aid our financial institutions and the American people in their efforts to keep ahead of inflation. This is an important section, Mr. Chairman. I hope it will remain intact, without amendments, when S. 1720 is reported out of committee.

Thank you, Mr. Chairman. Mr. Chairman, let me announce that I will be glad to answer questions in writing if any are submitted. Right now, I have to be at another committee meeting.

The CHAIRMAN. I understand. Thank you very much, Senator Hayakawa.

Senator Schmitt?

Senator SCHMITT. Thank you, Mr. Chairman. Gentlemen, if I have distilled some of what you have said, would you agree that for banks and thrifts to compete with the "nondepository," institutions—Sears, et cetera—that what you need to have over some period of time is the removal of the anticompetitive effects of State lines and the anticompetitive effects of service restrictions?

Mr. GUNDERSON. We did not in our statement, Senator—

Senator SCHMITT. I am not talking about—that's been mentioned.

EVALUATING MCFADDEN-DOUGLAS ACT

Mr. GUNDERSON. The position of our association on McFadden-Douglas, to bring you up to date on this, is that when that legislation was passed, we supported it. At that time, the members of our association felt it was appropriate. Until our members—and we have a process through our leadership group of 400-and-some bankers, who are representative of a cross-section of banking, that address the key policy issues—until the bankers in the Nation tell us that they feel it is an appropriate time for any change whatever, our position remains in support of McFadden-Douglas. We are looking at it. It has been part of our leadership conferences. We are evaluating it.

But certainly, our big concern is our inability to offer competitive products and services. We will continue to review and analyze McFadden-Douglas as part of a look at the entire competitive environment in which we operate. But we have not come out with any position that says it is necessary for banking.

Senator SCHMITT. Your principal new competitors have no State line restrictions of any significance.

Mr. McCORMICK. Senator, I think basically the reason why it is difficult to understand is that we have 15,000 banks in the country. Almost every one of them is a local provider of financial services and almost every one of them is willing to continue to be a local provider.

Senator SCHMITT. I am going to get that. I am trying to get to the issue of your ability to compete with these nondepository institutions for whom State boundaries are transparent.

Mr. GUNDERSON. Essentially, there is a nationwide network of banking. I think that is what Mr. McCormick is saying. With these banks and all of their offices—we are also talking about the entire financial industry. There is a nationwide network of financial institutions out there right now.

Senator SCHMITT. So you feel for you to compete—we do not need for the banks to compete. We do not need to worry about State lines, State line restrictions. We need to worry about service restrictions.

Mr. GUNDERSON. Products and services are certainly the No. 1 priority. We are evaluating and looking at all of the other areas.

What our position will be in time—there are a lot of forces moving around out there—it is difficult to predict, Senator.

Senator SCHMITT. I take it from what has just been said that you want to be sure that you preserve the ability of the banking system of this country to offer that local customer service that up until now has been unique to the banks and thrift institutions—

Mr. McCORMICK. Yes; the essential local nature—

Senator SCHMITT. [continuing]. May also be encroached upon by these other financial entities.

Mr. McCORMICK. If we could offer the products—it is not a problem that we have competitors that are nationwide; if we could offer the products we could compete locally.

Mr. GUNDERSON. Unfortunately, the only side they are encroaching is the deposit side. They have not deemed it necessary to come

in and help us out on the loan side, and that is the problem the communities are facing and are going to be facing ever more so in the future.

Senator SCHMITT. In that respect, do you see that if some of these service and product restrictions were removed that we could preserve the local customer services and the categorical services that those customers desire to have?

Mr. McCORMICK. I cannot think of a service that we would not be able to offer in our local marketplace that could be offered on a nationwide basis. As far as data communications, computer power—you name it, it is all available to the local bank on a vendor basis. I do not think that we have to throw out the essential local nature of the banking system in order to allow the banking system to compete in a free market.

Senator SCHMITT. You do not think that it would occur naturally, if we removed the restrictions on products and services, that as you began to focus on competing with Sears or Montgomery Ward's, or Merrill Lynch or someone like that, would that start to occupy the attention of the banking community, rather than providing local service?

Mr. McCORMICK. I don't believe so.

Mr. JENKINS. That wouldn't happen.

Senator SCHMITT. What is the protection there? In New Mexico, we are very, very much a local-service-type environment.

Mr. JENKINS. We are saying there will always be a good community bank. If bank management is good now, it will be better if you let them do more for the community. We think that instead of having money go off into these nondepository institutions, as it is now doing to the tune of \$160 billion, the local bank, if given the right, would be able to hold those funds for a lot of reasons. Your state is a good one. Look at the allegiance that a person living in a city or a town in your State has to his local banker. If given the opportunity, he will deal with the local banker. We are saying let's give that local banker a chance to do what he has to do.

CORRESPONDENT BANKING

One of the things necessary to understand is that there is something called the correspondent banking service. It is essential to our system of banking. It can do all kinds of things. When asked to perform, it performs quickly and quite efficiently. This is an area of banking that a lot of people do not understand. But there is no reason why they should. It is there, it acts, it works. It does a lot of things for a local bank in New Mexico. This correspondent banking system is in existence now. We are just trying to get some more power for the local bankers so that the system can help them even more.

A fellow in a small bank offering a money market mutual fund might have a little difficulty. You don't just put it on the books and say, "There it goes." You have to have some people who do this. You have to have trained people. But a small bank can turn to his correspondent in Kansas City or Oklahoma City or wherever and say, "Here. Give me a hand with this." That kind of thing can go on, and would go on.

Mr. McCORMICK. I agree with that. I do not see—I am not concerned about Merrill Lynch's competition, or Sears' competition, if I can offer the same product. I think I can offer it more thoughtfully and more responsibly in my marketplace than they will. As a matter of fact, if I can offer the same product, there is very little motivation for them to try to come into my marketplace and market it, because I will be tough competition, and the members of my association will be tough competition.

Mr. JENKINS. There is a thing called "market leverage." Nobody, any kind of a manager, goes wading into somebody else's market when that person has market leverage. But if he can find a spot where the local manager does not have the thing we call "market leverage," he will wade in with both feet. And he will succeed. What we are saying is we need to get the market leverage spread throughout the system of depository institutions.

Senator SCHMITT. Mr. Chairman, I cannot help in this discussion have come to mind analogies between some of the situations that are being faced and are being created and those that we have recently faced in the Commerce Committee in dealing with telecommunications and common carrier reform, where if you consider money as a form of communications then there is a whole bunch of—a whole bunch of analogies that come to mind here—the only major difference being that the A.T. & T. has just suddenly appeared on the scene, rather than having been there since 1934. The potential A.T. & T. It may be that we can come—we can benefit from the experience of how we have finally, I think, put together the beginnings of a truly competitive telecommunications system, while still protecting those local exchanges, which are banks, and the services that they are supposed to be providing. I may take a little time to explore that analogy, and come back to you with some thoughts.

Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, first of all, in light of the discussion that has just occurred, let me assure everyone that overhaul of McFadden/Glass-Steagall is not in this bill. Preliminary discussion we had about State boundaries but we are simply not intending at all to look at that, at those broad issues or broad reviews, until next year.

Let me ask you one general question. You have been here a long time. I have a lot of detailed questions. I would like to submit them to you for response in writing, and I am sure other senators will, as well, on some of the technical questions in the bill.

But as we closed off before Senator Hayakawa was here, one of you said something about middle ground. I was trying to make that point very strongly. And you say, well, you have other alternatives for the thrifts. That is a general statement.

But what I want to know, and let's see if I can put you on the spot—Are you willing to work with the committee and with the thrift industry in trying to come up with some compromises that both industries can live with? Are you willing to sit down and attempt to work on some compromises, some middle ground, as one of you used the term—I do not remember which one. Otherwise what I said is true, we will not have a bill and the nondepositories will roll merrily along, taking all of your money away from you.

Mr. JENKINS. Yes; the answer is, "yes, we would be more than happy to."

Mr. GUNDERSON. We have spent a great deal of time within our leadership conferences talking about this very same problem, and our support for the regulators' bill was a result of that.

And we commit to you wholeheartedly our support, and we apologize if our oral statement, the way it was put together, gave you the wrong impression—which it obviously did. Our association has long admired your commitment to assisting depository institutions to move into the present and into the future.

The CHAIRMAN. Don't worry about offending me personally. That is impossible to do.

Mr. GUNDERSON. I wanted to clear that up. I spent a great deal of time before you, and worked with you this past year. Many of those issues are in S. 1720. They are ones that we have been talking about for some time, and we are supporting those. The Pratt proposal just came up so fast, and with the kind of momentum that it seemed to build. We focused a great deal of our testimony, oral in particular, on that area. It does not mean we are not totally committed to working with you and with this committee in coming out with a solution that is viable, that is fair to us, that allows us to compete and allows the thrifts to remain viable and profitable. That is in everybody's best interest.

Mr. McCORMICK. It appeared to us that we were being told that in order to get any of these various regulatory changes that the banking industry has been asking for for years, that we were going to have to accept a broad proposal to give commercial bank powers to thrifts. Nobody has ever talked to us about working out anything any differently. As a matter of fact, that is what you have just said to us, basically, is hey, you guys, if you do not give commercial bank powers to thrifts, you ain't going to get nothing.

Now, if that is your position, I do not think that is a valid position. I do not think it is right.

NO THREATENING POSITION TAKEN

The CHAIRMAN. That is not my position at all, Mr. McCormick. I am just telling you, I have been in the Congress for 7 years and I am not threatening—that is not my position. I am just telling you the realities of the way these bills work. I came here 7 years ago with great dreams about what we could do, and I had to learn the hard way as I came through the chairs this direction, that with all of the diversity of the depository institutions and their internal arguments it is a problem. I told Dick Pratt that weeks ago, that if he thought he was going to get all of those additional powers for the thrifts without giving some to the banks, he better go back to Salt Lake City because he did not understand Congress.

It's just a fact of life. I am not threatening anybody. I am showing you the realities; that you cannot expect to get all of the powers that you want, because you are going to have other elements fighting you. In addition to Sears and all of the big boys who would like to keep you all locked up.

I am just telling you the pragmatic realities of what goes on. That is one of the reasons you start putting one of these bills together, and if you do not think H.R. 4986 or any other major bill

that I have seen since I have been here—and Senator Proxmire has been here longer than I have, but I think he would agree that if you put something in for someone, then you take something else out, and that is the way they are made. You have all heard the old story, if you are squeamish, you should not see sausages or laws made. I am sure that is probably true. I wish it were not. I wish it were nice and clean and we could sit here and say everybody is tickled to death about this. Like I say, it's not a particular position. It is just a statement about the political realities.

Senator Proxmire?

Senator Proxmire. I have a couple of questions. I apologize to the panel and to you, Mr. Chairman, for having to be absent. I am happy that you have given me a chance to ask some more.

Mr. McCormick, you recommend that we consider buying up thrift low-yielding portfolios. That would be a direct subsidy to thrifts to improve their earnings. As you know, this is a time of very serious budget restraint. I am sure that you share the position taken by Mr. Jenkins so persuasively at the beginning that we have to get our budget in shape if we are going to have any real financial growth or real economic growth in this country, so the taxpayers' funds may not be available for the purpose. And it may not be fair to use insured funds for that purpose.

What can we do to provide thrifts with asset powers if we do not provide a subsidy? What can we do?

Mr. McCORMICK. Senator, I certainly understand the fiscal problems that we are facing. I think our position is the thrifts are a creation of the Government. The Government has an insurance fund. Whether it is adequate or not is the business of the Government. The money is already gone, and the idea that we are making a new appropriation for a new purpose is simply not correct.

We think that the Government should directly determine what its obligations are and meet them. Now, I am not tickled about the idea of bailing out the thrifts any more than anybody else is, but we already have the liability. It is already there. And so most of these strategies that we have, it seems to me, are almost covering the hidden agenda which is how do we meet this liability we already have? Now, if the Government does not think they have a liability, then that is another matter.

Senator PROXMIRE. Let me just say, there are all kinds of ways we can meet the so-called liability. It can be to provide a Government bailout. That is one method. It may or may not be actually available. Congress may decide they will not do that. The administration may oppose that. We can do it by takeovers. We can do it in—I suppose that there are other ways, too.

Mr. McCORMICK. If you do it by takeovers, it seems to me the liability is still there. If you go to a bank and ask a bank to take over a large, failing thrift, they are going to look at it, they are going to come up with some sort of a market proposal that is going to pay some sort of small premium or bonus for the privilege of taking them over. But the very heavy losses that are there are still going to be sustained by the Government through the fund or through some other mechanism because there is so much money at stake. And so that strategy is not going to work.

Now, there are some possibilities in terms of the Government simply reassuring the general public; acknowledging to the general public that they have a responsibility here and that they are going to maintain the financial strength of the thrift industry through whatever means it takes. And since solvency is a state of the mind rather than an actual circumstance, in a lot of ways it probably would solve the problem.

TWO OPTIONS

Senator PROXMIRE. Then you say there are two options. Option No. 1 is a bailout by the Federal Government. Option No. 2 is you give them powers which you think should not be relevant to rescuing them from their financial dilemma.

Mr. MCCORMICK. I'm not aware that the power we're talking about giving them addresses the problem. The idea of making them commercial banks does not solve the problems.

Senator PROXMIRE. That's one of the purposes if, through these new powers, they can become profitable and they can begin to work their way out of their difficulties.

Mr. MCCORMICK. Our position is clear on that. We are not convinced that immediately making them commercial banks, No. 1, addresses their present earnings problem. After all, there are 5,000 thrifts. They will need at least 5,000 commercial loan officers that they don't have now. The thrift institution across the alley from me is approximately the same size as mine. I have 120 employees and he has 20. Now, theirs is a remarkably different—we are in remarkably different kinds of businesses, and so there is going to be a big transitional period which the thrifts must go through—there will be lots of expenses involved, a lot of mistakes made. The opportunity to be in the commercial loan business, commercial banking business, will not flow immediately to the bottom line, and so I think the hope here is a misplaced one.

Over the long pull, if the idea is that we can't afford to have specialized financial institutions offer these services, maybe it is appropriate that we do convert them to commercial banks. But if we do, we should convert them by passing legislation which would facilitate changing them to commercial banks by giving them commercial bank charters, and having them regulated by the same people and playing by the same rules that we do.

Senator PROXMIRE. Mr. Jenkins?

Mr. JENKINS. If nothing happens in the interest rate picture, then we are all going to be in trouble. So we need to hinge everything we think about on a downward thrust on interest rates.

S. 1720 deals with many issues in a helpful way—due-on-sale, usury, and another things. I have dealt with credits all of my life, and I have dealt with credits where you had a declining net worth. And as long as we got good cash flow and somebody running the things knew what he was doing and he was hurt by external factors, I would go along with the credit. He would generally make out all right because I am in there to support him.

These thrifts are very much in that category. I have worked with companies with a negative net worth and have helped pull them up. From a pure, hardnosed, numbers crunching credit point of view, they can make it if the interest rates come down.

Senator PROXMIRE. That is a useful comment. I take it—you say it is hard to tell what will happen in the future if interests stay high or go higher. You are going to have a far more serious problem than if we can get them under control and bring them down. If we can do it, we can do it perhaps without a bailout. We can do it with some mergers. We can do it by keeping them in business one way or the other, provided we can get a healthier, more wholesome financial situation.

Mr. JENKINS. That's our feeling. And without the healthier situation, which is in other hands, we are going to go nowhere.

Mr. McCORMICK. We can endorse that statement.

FUTURE OF THE HOUSING INDUSTRY

Senator PROXMIRE. I have one final question, Mr. McCormick. You expressed a view which I share very strongly and I expressed it to Secretary Regan yesterday. I am concerned about what will happen to housing, what is going to happen to housing if we now, in effect, give up on a specialized financial institution expertly staffed and designed primarily to serve housing, which is what the savings and loans have been. I share that, I share that concern.

At the same time, what is your view of the contrary argument, the new powers will augment the deposit base of thrifts by giving them a larger customer base, increase their earnings while they remain primarily housing oriented because that is the inclination, the business they know best. They have their expertise there, they have their contacts, and they will keep that.

Mr. McCORMICK. I think you can do it pretty well by crunching the numbers. The figures I have read indicate the S&L industry will lose about \$1.85 billion in assets in the next year if interest rates stay at the same level. The average commercial bank makes about \$1 billion on assets, and so it is difficult for me to believe that unless they get substantially out of the mortgage savings and loan business and very substantially into the commercial lending business, that they could hope to cover those kinds of losses. And so, the idea still has got to remain, if you make them commercial banks, they have to become primarily commercial banks in order to take the interest rate risk that apparently we are all sustaining in these kinds of financial markets.

Now, one of the things I would point out is that there are a lot of banks—

Senator PROXMIRE. Primarily at the housing instead of the savings and loan. The housing industry is one that, as we all know, is a basket case now. The figures are about 900,000 annual rate last month, and they tell us that it will be even lower in the ensuing months because permits are so low. So it looks very, very grim for that industry.

What do you see the effect of this legislation on housing?

Mr. McCORMICK. What I would suspect is that when the financial markets come back, assuming that they will; as they begin to come back, instead of savings and loans assuming their traditional role and beginning to aggressively support the housing industry as they have in the past, they will be busy moving into the commercial loan business and into the commercial banking business. And so instead of, as their assets flow back to them, reinvesting them in

housing, they are going to reinvest them in something else, and I do not think it will be to the benefit of the housing industry. I do not see how it could.

[The following information was received from the Independent Bankers Association:]

President
W. C. BENNETT, Chief Executive Officer
 Arthur State Bank
 Union, South Carolina 29379

First Vice President
ROBERT L. MCCORMICK JR., President/CEO
 Stillwater National Bank and Trust Company
 Stillwater, Oklahoma 74074

Second Vice President
JAMES D. HERRINGTON, Board Chairman
 Goodwill National Bank
 Caldwell, Kansas 67029

Treasurer
ARCH G. MAINOUS JR., President
 Citizens Union National Bank & Trust Company
 Lexington, Kentucky 40585



WASHINGTON
 OFFICE
**INDEPENDENT
 BANKERS ASSOCIATION OF AMERICA**

1825 MASSACHUSETTS AVENUE N.W. SUITE 202, WASHINGTON, D.C. 20036 202/332-8980

October 26, 1981

Honorable Jake Garn, Chairman
 Senate Committee on Banking, Housing
 and Urban Affairs
 5300 Dirksen Senate Office Bldg.
 Washington, DC 20510

Dear Mr. Chairman:

In the course of my testimony before your Committee
 on S. 1720, I expressed the view that the granting of
 commercial bank powers to thrift institutions was a
 solution to the problem which would have very adverse
 effects on housing.

In that connection, I believe you will find the
 attached proposal developed by one of our bankers with
 considerable experience in the housing finance area to
 be of considerable interest. Mr. Easterly is president
 and chief executive officer of the Capital Bank & Trust
 Company of Baton Rouge, Louisiana, and a past president
 of IBAA.

Sincerely,

Robert L. McCormick, Jr.
 First Vice President

RLM/nls
 Enclosure

In speaking to investors, bankers, builders and realtors, the consensus seems to be that a 12 percent interest rate on home mortgage loans will get the housing market moving again. To illustrate the impact a lower interest rate would have on loan applications, consider that to qualify for a 60-thousand dollar home, with five percent down, at 16 percent over 30 years, a family must have an income of over 18 thousand dollars a year. For the same loan at 12 percent interest, that family income could be almost 10-thousand dollars less.

Some kind of government subsidy will be necessary to provide potential home owners with a 12 percent interest rate. Recently, the government has subsidized home buying through various tax-free housing authority bonds (sold by states and municipalities) and is currently involved in some builder-developer schemes which permit investors to pay part of the homeowner's payment, and take the related tax deduction. We will never know what a program like that costs the government in lost taxes, and such a plan will not solve the housing crisis.

To increase home ownership, we propose instead that the government lend buyers the difference between the 12 percent buyers can afford, and the rate expected by investors (16 percent at present). This subsidy would continue while rates are high, and then be repaid when rates drop or when the home is sold.

Specifically, we propose that home buyers sign a variable rate mortgage, which will be amortized at that magic 12 percent over, say, a thirty year period. The borrower's payment amount will be constant. In order to attract investors, who in today's market expect 16 percent for their mortgage money, the government's loan would make up the difference between the 12 percent paid by the homeowner and the 16 percent expected by the investor.

The experts predict that interest rates will decline over the next two to three years. The homeowner would continue to pay the 12 percent interest even after the rates decline below 12 percent, with the excess going to pay the monies advanced by the government. After the subsidy amount is totally repaid, the homeowner's note can be reduced to reflect the lower rate. Of course, the variable rate would be one acceptable to Fannie Mae and other investors.

In the event the home is sold before the government has been fully reimbursed, it is quite likely that the equity built up from the monthly payments plus inflation-caused appreciation will be enough to completely repay the monies advanced by the government. We recommend that the proceeds of the sale be distributed as follows. First, the homeowner is repaid the downpayment made when he purchased the home. Second, the government is repaid any of the subsidy outstanding. Third, all other proceeds will belong to the homeowner.

The money the government advances will not be considered a debt the borrower owes; however, the funds will be repaid if the rates drop or the house is sold at a profit, as mentioned above. It is recommended that this program not be limited to low income families, but that a ceiling of 80-thousand dollars be placed on the eligible loan amount.

As to the cost of this program, in today's market, housing starts are at a level of about one million per year. Assuming a loan amount of 60-thousand dollars at a rate of 16 percent, if every new home were financed under this plan, the difference in monthly interest (four percent, or 16 minus 12) would be 200 dollars per house or 200 million dollars per month. That's 2.4 billion dollars annually--considerably less than the All-Savers Bill currently in Congress with a price tag of 4 billion dollars.

In other words, this program would differ from most subsidy programs, in that it would be reasonable to expect repayment of the subsidy. This allows for a negligible long-term expenditure by the government, while it accomplishes the purpose of stimulating home construction when it's most needed. The government could even charge interest on the money lent, but we do not recommend that. The increase in tax revenues from new jobs and construction will offset the loss in interest.

Keeping records and servicing loans under this plan will be inexpensive and simple with today's technology and computers. We figure that the additional cost to handle this type of program will be about five dollars a month for each loan, and that amount could be added to the homeowner's payment as a servicing fee.

In summary, this plan will cost the government very little in the long run, and is simple enough and practical enough to work.

Senator PROXMIRE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Proxmire.

Gentlemen, I am sure there will be additional questions for you to respond to in writing. In closing, Mr. Jenkins, I would just like to respond to your statement on the opening on page 1: "The current signals from Congress, however, are discouraging. Further reductions in spending are essential."

I do not think you would have any two senators who would agree with that statement more, that more reductions are needed. Because Senator Proxmire and I have been voting for reductions before it became politically popular to do so, a long time before. The point that bothers me about discouraging signals, as I listen to the Henry Kaufmans of this world and the great oracles of Wall Street and so on, talk about how the President's program is not working, may not have produced the results we would like yet. But I would submit to you that it is working, it is working dramatically, because I would ask anybody to dispute this statement. If we had spent an additional \$14 billion in fiscal 1981, or spent an additional \$36 billion in 1982, which has been cut, that is law, that is not promises as Congresses and Presidents of the past in both parties have promised. I would just submit that I think the interest rates would be quite higher, had the \$50 billion still been there.

So to the cynics and critics, I would refer them to Bill Butcher's article of a few weeks ago where he talked about the young man who was praying for patience and said, "And I want it right now." Or also to the fellow who had bought a new air conditioner and was claiming that it had not worked, even his house was not cool. It did not matter that the air conditioner had not yet been installed.

But I would suggest that the very moderate reduction of about 3 percent would not have occurred. Mr. Kaufman, in private conversations admitted that to me, too, that he felt that the interest rates would be considerably higher. He will not, apparently, say that publicly. He just wants to condemn and add fuel to the argument that it is not working.

I agree with your statement completely that the only long-term solution to these problems is lower interest rates, lower inflation, and that means Congress has to cut more expenditures. But I did not want to leave it to all of the critics that it is not working. It is working, and I would be willing to bet you you would have at least a 25 percent prime right now, or higher, if we had that additional \$50 billion in the budget that Congress has cut in fiscal 1981 and 1982.

Thank you very much for your testimony.

[Whereupon, at 11:48 a.m., the hearing was adjourned.]

[Supplementary statement which follows was received from the American Bankers Association:]

OCTOBER 29, 1981

SUPPLEMENTAL STATEMENT
OF THE
AMERICAN BANKERS ASSOCIATION

EMERGENCY POWERS FOR FEDERAL FINANCIAL REGULATORS

TITLE I, Parts D & E

ABA testimony stated that the regulatory agencies should be provided a "safety net" mechanism to confront the problems of troubled institutions. At the same time, we believe that these expanded authorities should be subject to the following conditions:

1. The significant exceptions to current law provided for in the legislation must be temporary, and terminated in no more than two years.
2. The financial assistance authority to both the FDIC and FSLIC must be identical in its applicability to depository institutions under their jurisdictions.
3. The emergency merger and acquisition authority granted to the agencies must be fully comparable and patterned after that proposed for the FDIC. However, all possibilities for intrastate mergers and acquisitions must be exhausted prior to utilization of provisions for interstate mergers and acquisitions.

In light of these conditions, we submit the following amendment to S. 1720.

On page 25, strike line 1 and all that follows through line 3 and insert in lieu thereof the following:

"different types in the same State; third, between institutions of the same type in different States; and fourth, between institutions of different type in different States. In any circumstances where the Federal regulatory agencies find it necessary to exercise option three or four above, the agencies must consider all possible mergers or acquisitions with institutions in States adjoining the State of the acquired institution."

EXPLANATION OF THE AMENDMENT

This amendment directs the Federal regulatory agencies to consider all possible mergers and acquisitions between institutions within the same state prior to the use of any interstate options. In addition, this amendment requires that interstate possibilities should focus upon contiguous states before being considered on a nationwide basis.

SECONDARY MARKET PURCHASE AUTHORITY - SEC. 173Amendment

Sec. 173(b) amending Sec. 305(a)(2) of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)) is further amended by inserting a new fourth sentence to read as follows: "The Corporation shall not impose any sales fee or charges upon eligible sellers who are not members of a Federal Home Loan Bank which differ from those imposed upon eligible sellers who are such members."

Explanation

The Federal Home Loan Mortgage Corporation is seeking to amend its Charter Act to remove the limitation on the number of mortgages more than one year old it may purchase in order to facilitate the development of its SNAP program, which permits residential mortgage lenders to sell older, low-yielding mortgages. The earnings problems created by low-yielding mortgages is not a matter isolated to thrift institutions only. Many banks have sizeable portfolios of low-yielding mortgage loans, too.

The Mortgage Corporation operating under its present rules and regulations charges banks and mortgage bankers a 1/2 percent sales fee, while institutions that are members of the Federal Home Loan Bank system are not charged a fee. The reason for this policy stems from the fact that the initial capital of the Corporation was originally contributed by the twelve Federal Home Loan Banks. The Corporation takes the position that banks and mortgage bankers are making their contribution to the capital of the Corporation by payment of the 1/2 percent sales fee. However, the cumulative

amount of sales fees paid by banks and mortgage bankers over the past eleven year period exceeds the \$100 million in capital contributed by the Federal Home Loan Banks and there appears to be no justification for the Corporation's continuing discrimination against banks and mortgage bankers. The Corporation, in fact, recognizes the inequity of its present policies and proposes to address the situation in proposed legislation entitled the "Federal Home Loan Mortgage Corporation Charter Act."

However, since S. 1720 purports to enhance the competitiveness of depository institutions, it is inconsistent with the thrust of the legislation to permit the continuation of a discriminatory pricing practice based on no rational basis other than membership in the Federal Home Loan Bank System. If the Committee acts to broaden the authority of the Corporation, it should be done so only in the clear understanding that all institutions aggrieved with low yielding mortgage loans will have the opportunity to sell their mortgages to the Corporation on an equal fee basis.

NATIONAL BANK LENDING LIMITS - SECTION 201

In order to provide national banks with more flexible and responsive single borrower limits, and to make them more competitive with their state-chartered counterparts, our Association would recommend an amendment to Section 201 of S. 1720 that would provide the Comptroller of the Currency with authority to regulate single borrower limits.

Amendment to Section 201

On page 46, line 11, through page 49, line 25, delete Section 201 in its entirety and substitute therefor the following:

"Section 201. Section 5200 of the Revised Statutes (12 U.S.C. 84) is amended to read as follows:

'Section 5200(a). The Comptroller of the Currency may, by rule or regulation, establish limitations on the total loans or extensions of credit that may be outstanding at one time from any national bank to any person.

'(b) For the purpose of this section -

'(1) the terms "loans or extensions of credit" includes all advances of funds a person on the basis of that person's obligation to repay the funds or repayable from specific property pledged by or on behalf of that person; and

'(2) the term "person" includes an individual, sole proprietorship, joint venture, association, trust, estate, business trust, corporation, sovereign government or agency, instrumentality, or political subdivision thereof, or any similar entity or organization.

'(c) For the purpose of this section, the Comptroller of the Currency may, by rule or regulation, establish separate limitations on particular types or classes of loans or extensions of credit.'

Explanation of Amendment

This amendment would replace the present language of Section 201 that places relatively inflexible limits on the amount that any person may borrow from a national bank with language that would authorize the Comptroller of the Currency to prescribe individual borrower limits with considerable flexibility. The Comptroller would be authorized to design individual borrower limits based on type of lending, and could provide different limits for different types of loans.

Need for Amendment

This amendment is needed in order to permit the Comptroller of the Currency and the national banking system to respond more flexibly and effectively to changes in loan demand and the needs of individual borrowers or classes of borrowers. In volatile loan markets such as those that have characterized recent economic periods, many, particularly smaller banks have found that loan demand of individual borrowers has exceeded the capability of their lending limits to meet that demand. This amendment would allow the Comptroller of the Currency, in appropriate cases, to adjust national bank single borrower limits in ways that will effectively adjust to such changes.

Now, there are some possibilities in terms of the Government simply reassuring the general public; acknowledging to the general public that they have a responsibility here and that they are going to maintain the financial strength of the thrift industry through whatever means it takes. And since solvency is a state of the mind rather than an actual circumstance, in a lot of ways it probably would solve the problem.

TWO OPTIONS

Senator PROXMIRE. Then you say there are two options. Option No. 1 is a bailout by the Federal Government. Option No. 2 is you give them powers which you think should not be relevant to rescuing them from their financial dilemma.

Mr. McCORMICK. I'm not aware that the power we're talking about giving them addresses the problem. The idea of making them commercial banks does not solve the problems.

Senator PROXMIRE. That's one of the purposes if, through these new powers, they can become profitable and they can begin to work their way out of their difficulties.

Mr. McCORMICK. Our position is clear on that. We are not convinced that immediately making them commercial banks, No. 1, addresses their present earnings problem. After all, there are 5,000 thrifts. They will need at least 5,000 commercial loan officers that they don't have now. The thrift institution across the alley from me is approximately the same size as mine. I have 120 employees and he has 20. Now, theirs is a remarkably different—we are in remarkably different kinds of businesses, and so there is going to be a big transitional period which the thrifts must go through—there will be lots of expenses involved, a lot of mistakes made. The opportunity to be in the commercial loan business, commercial banking business, will not flow immediately to the bottom line, and so I think the hope here is a misplaced one.

Over the long pull, if the idea is that we can't afford to have specialized financial institutions offer these services, maybe it is appropriate that we do convert them to commercial banks. But if we do, we should convert them by passing legislation which would facilitate changing them to commercial banks by giving them commercial bank charters, and having them regulated by the same people and playing by the same rules that we do.

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Mr. JENKINS. That's our feeling. And without the healthier situation, which is in other hands, we are going to go nowhere.

Mr. McCORMICK. We can endorse that statement.

FUTURE OF THE HOUSING INDUSTRY

Senator PROXMIRE. I have one final question, Mr. McCormick. You expressed a view which I share very strongly and I expressed it to Secretary Regan yesterday. I am concerned about what will happen to housing, what is going to happen to housing if we now, in effect, give up on a specialized financial institution expertly staffed and designed primarily to serve housing, which is what the savings and loans have been. I share that, I share that concern.

At the same time, what is your view of the contrary argument, the new powers will augment the deposit base of thrifts by giving them a larger customer base, increase their earnings while they remain primarily housing oriented because that is the inclination, the business they know best. They have their expertise there, they have their contacts, and they will keep that.

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Senator PROXMIRE. Primarily at the housing instead of the savings and loan. The housing industry is one that, as we all know, is a basket case now. The figures are about 900,000 annual rate last month, and they tell us that it will be even lower in the ensuing months because permits are so low. So it looks very, very grim for that industry.

What do you see the effect of this legislation on housing?

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[The following information was received from the Independent Bankers Association:]

President: W. C. BENNETT, Chief Executive Officer, Arthur State Bank, Union, South Carolina 29379
 First Vice President: ROBERT L. MCCORMICK JR., President/CEO, Saltwater National Bank and Trust Company, Savannah, Oklahoma 74074
 Second Vice President: JAMES D. HERRINGTON, Board Chairman, Centimeter National Bank, Columbus, Kansas 67029
 Treasurer: ARCH G. MAINOUS JR., President, Citizens Union National Bank & Trust Company, Lexington, Kentucky 40506



Independent
BANKERS ASSOCIATION OF AMERICA

WASHINGTON
 OFFICE

1625 MASSACHUSETTS AVENUE N.W. - SUITE 202, WASHINGTON, D.C. 20036 202/332-8980

October 26, 1981

Honorable Jake Garn, Chairman
 Senate Committee on Banking, Housing
 and Urban Affairs
 5300 Dirksen Senate Office Bldg.
 Washington, DC 20510

Dear Mr. Chairman:

In the course of my testimony before your Committee on S. 1720, I expressed the view that the granting of commercial bank powers to thrift institutions was a solution to the problem which would have very adverse effects on housing.

In that connection, I believe you will find the attached proposal developed by one of our bankers with considerable experience in the housing finance area to be of considerable interest. Mr. Easterly is president and chief executive officer of the Capital Bank & Trust Company of Baton Rouge, Louisiana, and a past president of IBAA.

Sincerely,

Robert L. McCormick, Jr.
 First Vice President

RLM/nls
 Enclosure

In speaking to investors, bankers, builders and realtors, the consensus seems to be that a 12 percent interest rate on home mortgage loans will get the housing market moving again. To illustrate the impact a lower interest rate would have on loan applications, consider that to qualify for a 60-thousand dollar home, with five percent down, at 16 percent over 30 years, a family must have an income of over 38-thousand dollars a year. For the same loan at 12 percent interest, that family income could be almost 10-thousand dollars less.

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Specifically, we propose that home buyers sign a variable rate mortgage, which will be amortized at that magic 12 percent over, say, a thirty-year period. The borrower's payment amount will be constant. In order to attract investors, who in today's market expect 16 percent for their mortgage money, the government's loan would make up the difference between the 12 percent paid by the homeowner and the 16 percent expected by the investor.

The experts predict that interest rates will decline over the next two to three years. The homeowner would continue to pay the 12 percent interest even after the rates decline below 12 percent, with the excess going to pay the monies advanced by the government. After the subsidy amount is totally repaid, the homeowner's note can be reduced to reflect the lower rate. Of course, the variable rate would be one acceptable to Fannie Mae and other investors.

In the event the home is sold before the government has been fully reimbursed, it is quite likely that the equity built up from the monthly payments plus inflation-caused appreciation will be enough to completely repay the monies advanced by the government. We recommend that the proceeds of the sale be distributed as follows. First, the homeowner is repaid the downpayment made when he purchased the home. Second, the government is repaid any of the subsidy outstanding. Third, all other proceeds will belong to the homeowner.

The money the government advances will not be considered a debt the borrower owes; however, the funds will be repaid if the rates drop or the house is sold at a profit, as mentioned above. It is recommended that this program not be limited to low income families, but that a ceiling of 80-thousand dollars be placed on the eligible loan amount.

As to the cost of this program, in today's market, housing starts are at a level of about one million per year. Assuming a loan amount of 60-thousand dollars at a rate of 16 percent, if every new home were financed under this plan, the difference in monthly interest (four percent, or 16 minus 12) would be 200 dollars per house or 200 million dollars per month. That's 2.4 billion dollars annually--considerably less than the All-Savers Bill currently in Congress with a price tag of 4 billion dollars.

In other words, this program would differ from most subsidy programs, in that it would be reasonable to expect repayment of the subsidy. This allows for a negligible long-term expenditure by the government, while it accomplishes the purpose of stimulating home construction when it's most needed. The government could even charge interest on the money lent, but we do not recommend that. The increase in tax revenues from new jobs and construction will offset the loss in interest.

Keeping records and servicing loans under this plan will be inexpensive and simple with today's technology and computers. We figure that the additional cost to handle this type of program will be about five dollars a month for each loan, and that amount could be added to the homeowner's payment as a servicing fee.

In summary, this plan will cost the government very little in the long run, and is simple enough and practical enough to work.

Senator PROXMIRE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Proxmire.

Gentlemen, I am sure there will be additional questions for you to respond to in writing. In closing, Mr. Jenkins, I would just like to respond to your statement on the opening on page 1: "The current signals from Congress, however, are discouraging. Further reductions in spending are essential."

I do not think you would have any two senators who would agree with that statement more, that more reductions are needed. Because Senator Proxmire and I have been voting for reductions before it became politically popular to do so, a long time before. The point that bothers me about discouraging signals, as I listen to the Henry Kaufmans of this world and the great oracles of Wall Street and so on, talk about how the President's program is not working, may not have produced the results we would like yet. But I would submit to you that it is working, it is working dramatically, because I would ask anybody to dispute this statement. If we had spent an additional \$14 billion in fiscal 1981, or spent an additional \$36 billion in 1982, which has been cut, that is law, that is not promises as Congresses and Presidents of the past in both parties have promised. I would just submit that I think the interest rates would be quite higher, had the \$50 billion still been there.

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But I would suggest that the very moderate reduction of about 3 percent would not have occurred. Mr. Kaufman, in private conversations admitted that to me, too, that he felt that the interest rates would be considerably higher. He will not, apparently, say that publicly. He just wants to condemn and add fuel to the argument that it is not working.

I agree with your statement completely that the only long-term solution to these problems is lower interest rates, lower inflation, and that means Congress has to cut more expenditures. But I did not want to leave it to all of the critics that it is not working. It is working, and I would be willing to bet you you would have at least a 25 percent prime right now, or higher, if we had that additional \$50 billion in the budget that Congress has cut in fiscal 1981 and 1982.

Thank you very much for your testimony.

[Whereupon, at 11:48 a.m., the hearing was adjourned.]

[Supplementary statement which follows was received from the American Bankers Association:]

OCTOBER 29, 1981

SUPPLEMENTAL STATEMENT

OF THE

AMERICAN BANKERS ASSOCIATION

EMERGENCY POWERS FOR FEDERAL FINANCIAL REGULATORSTITLE I, Parts D & E

ABA testimony stated that the regulatory agencies should be provided a "safety net" mechanism to confront the problems of troubled institutions. At the same time, we believe that these expanded authorities should be subject to the following conditions:

1. The significant exceptions to current law provided for in the legislation must be temporary, and terminated in no more than two years.
2. The financial assistance authority to both the FDIC and FSLIC must be identical in its applicability to depository institutions under their jurisdictions.
3. The emergency merger and acquisition authority granted to the agencies must be fully comparable and patterned after that proposed for the FDIC. However, all possibilities for intrastate mergers and acquisitions must be exhausted prior to utilization of provisions for interstate mergers and acquisitions.

In light of these conditions, we submit the following amendment to S. 1720.

On page 25, strike line 1 and all that follows through line 3 and insert in lieu thereof the following:

"different types in the same State; third, between institutions of the same type in different States; and fourth, between institutions of different type in different States. In any circumstances where the Federal regulatory agencies find it necessary to exercise option three or four above, the agencies must consider all possible mergers or acquisitions with institutions in States adjoining the State of the acquired institution."

EXPLANATION OF THE AMENDMENT

This amendment directs the Federal regulatory agencies to consider all possible mergers and acquisitions between institutions within the same state prior to the use of any interstate options. In addition, this amendment requires that interstate possibilities should focus upon contiguous states before being considered on a nationwide basis.

SECONDARY MARKET PURCHASE AUTHORITY - SEC. 173Amendment

Sec. 173(b) amending Sec. 305(a)(2) of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)) is further amended by inserting a new fourth sentence to read as follows: "The Corporation shall not impose any sales fee or charges upon eligible sellers who are not members of a Federal Home Loan Bank which differ from those imposed upon eligible sellers who are such members."

Explanation

The Federal Home Loan Mortgage Corporation is seeking to amend its Charter Act to remove the limitation on the number of mortgages more than one year old it may purchase in order to facilitate the development of its SWAP program, which permits residential mortgage lenders to sell older, low-yielding mortgages. The earnings problems created by low-yielding mortgages is not a matter isolated to thrift institutions only. Many banks have sizeable portfolios of low-yielding mortgage loans, too.

The Mortgage Corporation operating under its present rules and regulations charges banks and mortgage bankers a 1/2 percent sales fee, while institutions that are members of the Federal Home Loan Bank system are not charged a fee. The reason for this policy stems from the fact that the initial capital of the Corporation was originally contributed by the twelve Federal Home Loan Banks. The Corporation takes the position that banks and mortgage bankers are making their contribution to the capital of the Corporation by payment of the 1/2 percent sales fee. However, the cumulative

amount of sales fees paid by banks and mortgage bankers over the past eleven year period exceeds the \$100 million in capital contributed by the Federal Home Loan Banks and there appears to be no justification for the Corporation's continuing discrimination against banks and mortgage bankers. The Corporation, in fact, recognizes the inequity of its present policies and proposes to address the situation in proposed legislation entitled the "Federal Home Loan Mortgage Corporation Charter Act."

However, since S. 1720 purports to enhance the competitiveness of depository institutions, it is inconsistent with the thrust of the legislation to permit the continuation of a discriminatory pricing practice based on no rational basis other than membership in the Federal Home Loan Bank System. If the Committee acts to broaden the authority of the Corporation, it should be done so only in the clear understanding that all institutions aggrieved with low yielding mortgage loans will have the opportunity to sell their mortgages to the Corporation on an equal fee basis.

NATIONAL BANK LENDING LIMITS - SECTION 201

In order to provide national banks with more flexible and responsive single borrower limits, and to make them more competitive with their state-chartered counterparts, our Association would recommend an amendment to Section 201 of S. 1720 that would provide the Comptroller of the Currency with authority to regulate single borrower limits.

Amendment to Section 201

On page 46, line 11, through page 49, line 25, delete Section 201 in its entirety and substitute therefor the following:

"Section 201. Section 5200 of the Revised Statutes (12 U.S.C. 84) is amended to read as follows:

'Section 5200(a). The Comptroller of the Currency may, by rule or regulation, establish limitations on the total loans or extensions of credit that may be outstanding at one time from any national bank to any person.

' (b) For the purpose of this section -

' (1) the terms "loans or extensions of credit" includes all advances of funds a person on the basis of that person's obligation to repay the funds or repayable from specific property pledged by or on behalf of that person; and

' (2) the term "person" includes an individual, sole proprietorship, joint venture, association, trust, estate, business trust, corporation, sovereign government or agency, instrumentality, or political subdivision thereof, or any similar entity or organization.

' (c) For the purpose of this section, the Comptroller of the Currency may, by rule or regulation, establish separate limitations on particular types or classes of loans or extensions of credit.'

Explanation of Amendment

This amendment would replace the present language of Section 201 that places relatively inflexible limits on the amount that any person may borrow from a national bank with language that would authorize the Comptroller of the Currency to prescribe individual borrower limits with considerable flexibility. The Comptroller would be authorized to design individual borrower limits based on type of lending, and could provide different limits for different types of loans.

Need for Amendment

This amendment is needed in order to permit the Comptroller of the Currency and the national banking system to respond more flexibly and effectively to changes in loan demand and the needs of individual borrowers or classes of borrowers. In volatile loan markets such as those that have characterized recent economic periods, many, particularly smaller banks have found that loan demand of individual borrowers has exceeded the capability of their lending limits to meet that demand. This amendment would allow the Comptroller of the Currency, in appropriate cases, to adjust national bank single borrower limits in ways that will effectively adjust to such changes.

NATIONAL BANK REAL ESTATE ACTIVITIES - SECTION 203

Because the last amendment to Section 24 of the Federal Reserve Act was enacted in 1974, national banks governed by that section are ill-equipped to face the real estate market of the '80s. Our Association strongly believes that language more appropriate to national bank real estate activities than that contained in proposed Section 203 of S. 1720 should be included in any final legislation, and that these real estate powers should also be extended to state-chartered banks because of the national interest in the health of housing and real estate finance. Accordingly, we offer the following amendment to Section 203.

Amendment to Section 203

On page 50, line 16 through page 53, line 10, delete Section 203 in its entirety and substitute therefor the following:

"Section 203(a). Section 24 of the Federal Reserve Act (12 U.S.C. 371) is amended to read as follows:

'Section 24(a) Notwithstanding any other provision of Federal or state law, any bank, as defined in Section 3 of the Federal Deposit Insurance Act, may make loans on the security of liens on interests in real estate.

'(b) Any loan made pursuant to this section shall be subject to any terms, conditions or limitations which may be prescribed by the Comptroller of the Currency by rule or regulation.

'(b) Section 28 of the National Bank Act (Act of June 3, 1864, 12 U.S.C. 29), as amended, is amended by adding thereto the following new paragraph:

'Fifth. Such as shall be authorized, by rule or regulation of the Comptroller of the Currency, to be held for development purposes, or to provide additional compensation or return, in conjunction with a real estate loan or other transaction that may be otherwise permissible under Section 24 of the Federal Reserve Act (12 U.S.C. 371).'

'(c) Section 1(b) of the Bank Services Corporation Act (Pub. L. 87-856, 12 U.S.C. 1861 (b)) is amended by adding before the period at the end thereof the following new language:

'and means, in addition, any services which a national or state bank in the state in which the bank service corporation is incorporated may lawfully perform for itself.'

Explanation of Amendment

This amendment would allow commercial banks to compete effectively with savings and loan associations, mutual savings banks, and mortgage banking associations by removing many of the outdated restrictions governing member bank real estate lending, and by applying to state nonmember banks the same real estate lending restrictions as those governing member banks. The amendment would provide the Comptroller of the Currency with regulatory authority

in the real estate lending area as broad as that given elsewhere in S. 1720 to the Federal Home Loan Bank Board.

The amendment would also authorize national banks, under the regulatory supervision of the Comptroller of the Currency, to invest directly in equity interests in real estate for development purposes or to provide additional compensation in real estate loan transactions otherwise authorized under the lending provisions of Section 24 of the Federal Reserve Act. This equity investment authority is intended to allow banks to purchase real estate to be developed in the future in order to help keep land acquisition costs for real estate development under control. In addition, these provisions would allow national banks to take "equity kickers" so as to compensate themselves, in certain circumstances, for below market rate of interest loans to development companies with a share in the appreciation of the real estate under development or construction. Both of these provisions could be both antinflationary and countercyclical in assisting in the finance of real estate development in ways that help reduce real estate costs and maintain real estate finance through all phases of the real estate economic cycle.

Need for the Amendment

This amendment is needed in order to permit bank real estate lenders to compete in the housing finance market of the '80s. Section 24 of the Federal Reserve Act is at present an ambiguous combination of archaic restrictions on real estate lending and jerrybuilt exceptions found vital to permit any national bank real estate lending. Originally enacted at a time when any real estate lending by banks, particularly residential housing credit, was considered at best a speculative activity, it has been designed more to keep lenders from making any risk decisions than to serve the real estate finance needs of bank customers.

To remedy this situation, this amendment would authorize banks to engage in real estate lending on the same basis as their savings and loan association competitors, leaving to the Comptroller of the Currency the duty to ensure through regulations, that real estate lending does not endanger the safety or soundness of the banking system. In addition to broadly authorizing bank lending on the security of real estate, the amendment would allow national banks to take equity interests in real estate in two limited circumstances: first, as part of a long-term land development project in order to dampen the inflationary impact of increasing real estate value on such development, and, second, as part of an otherwise authorized real estate loan in order to provide equity returns to a bank where it is necessary to maintain a lower than market rate of interest on the loan, or where interest rate alone would not induce a bank to enter into a particular transaction.

The amendment would also broaden the authority of bank service corporations so that service corporations could perform any service the banks that chartered them could perform. This authority would place bank service corporations on a par with savings and loan service corporations, particularly in such areas as real estate development.

**SECTION 23A OF FEDERAL RESERVE ACT -
SECTION 210 OF S. 1720**

Amendment

Sec. 210(c) is amended on page 69, --

- (1) on line 6 by striking-out the period, and adding "or the non—
recourse purchase of loans at fair market value from affiliated
banks where such loans were originally extended on no more
favorable terms than those available to borrowers of comparable
credit standing."

Explanation

This amendment would preserve the existing exemption in Section 23A of the Federal Reserve Act. Elimination of this exemption would have a profound effect on the efficiencies of institutions affiliated in two different ways.

First, it would impact on bank holding company subsidiary banks which are less than 80% owned by the parent holding company. Secondly, it would impact on so-called "chain banking" systems, due to the expansion of the definition of "affiliate", and would cover a larger number of those organizations.

AMENDMENTS TO THE FINANCIAL INSTITUTIONS REGULATORY ACT - SECTIONS 221-232

Although many of the provisions contained in Sections 221 to 232 of S. 1720 would provide some relief from the more onerous requirements of the Financial Institutions Regulatory Act (FIRA), the bank regulatory agencies have described these amendments as primarily technical in nature. Our Association therefore offers the following package of amendments to correct the major substantive problems that bankers have found with FIRA.

Amendment to S. 1720

On page 74, line 6, delete the word "and" and on page 74, line 8 insert before the period at the end thereof the following:

"and by inserting the figure '\$25,000' in lieu of the figure '\$10,000' in paragraph (4) thereof."

Explanation of Amendment

This amendment would authorize member banks to lend up to \$25,000 to each of their executive officers in place of the current limit of \$10,000.

Need for the Amendment

Not only would the amendment help make up for the inflation that has occurred since executive officer borrowing restrictions were first enacted in 1913, but the amendment would also bring into accordance the provisions of this section with Section 22(h) of the Federal Reserve Act, that requires prior board of director approval for aggregate loans to one executive officer (or other bank management official) over \$25,000.

Amendment to S. 1720

On page 76, line 11, Section 225 is amended by designating the existing provision as subsection (b) and inserting the following new subsection immediately after the words "Sec. 225.":

"(a) Section 22(h)(1) of the Federal Reserve Act (12 U.S.C. 375b(1)) is amended by deleting the final sentence thereof, and changing the period at the end of the preceding sentence to a comma, and adding the following language:

"in the case of a national banking association, or by the applicable State law in the case of a State member bank."

Explanation of Amendment

This amendment would provide that state single borrower limits, rather than the single borrower limits of the National Bank Act would apply to State member and nonmember banks subject to FIRA.

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Need for the Amendment

As presently drafted, FIRA applies national bank single borrower limits to State chartered banks. This has been a significant new intrusion of Federal regulatory authority into what has traditionally been the province of State banking law and regulation.

State single borrower limits have not been demonstrated inadequate to prevent abuses in the concentration of credit to single borrowers generally, and there is no reason to believe that, under the aggregation provision of FIRA, the single borrower limits of the States would prove inadequate to curb insider abuses.

Amendment to S. 1720

On page 76, line 11 through 13, Section 225 is amended to read as follows:

"Sec. 225. Section 22(h)(2) of the Federal Reserve Act (12 U.S.C. 375b(2)) is amended by striking the phrase 'in advance by a majority of the entire' and inserting 'by a loan committee of the bank, including at least one member of the' in lieu thereof."

Explanation of Amendment

This amendment would authorize a committee of a bank's board of directors, rather than the full board as presently required, to approve loans to bank management officials, and would allow loan approvals by the board's committee to be made after loan consummation rather than in advance as presently required.

Need for the Amendment

This amendment is needed in order to allow banks to retain qualified directors and to permit more expeditious and less intrusive loan approvals on loans to bank management officials. It would not pose any additional risk of abuse because the provisions of Section 22(h)(3) of the Federal Reserve Act prohibiting preferential loans would remain in effect, and because the bank regulatory agencies would retain supervisory and regulatory authority over bank management conduct.

Amendment to S. 1720

On page 82, line 9, through page 83, line 24, delete Secs. 231 and 232 in their entirety and substitute therefor the following:

"Sec. 231. Section 801 of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (12 U.S.C. 1972(2)) is amended by repealing paragraph (G) thereof.

"Sec. 232. Section 901 of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 (12 U.S.C. 1817(k)) is hereby repealed.

Explanation of Amendment

This amendment would repeal the requirements of the Financial Institutions Regulatory Act that bank principal shareholders and executive officers file annual reports with their banks, for forwarding to and disclosure in the aggregate by the bank regulatory agencies, on their borrowings from their own and from correspondent banks.

Need for the Amendment

The reports required under Titles VIII and IX of FIRA have proved of little interest to the public, needlessly obtrusive into the privacy of shareholders and officers, and, in some cases, extremely difficult for individuals to file. In addition, the information contained in these reports had previously been available to bank examiners and bank boards of directors through the management loan approval process. There is no justification for the continuation of reports providing so little benefit at such considerable cost.

Amendment to S. 1720

On pages 82, 83, and 84, renumber Secs. 231, 232, and 233 as 232, 233, and 234, and insert, beginning on page 82, line 8, the following new Section:

"Change in Bank Control

"Sec. 231. Subsection (j) of section 7 of the Federal Deposit Insurance Act (12 U.S.C. 1817(j)) is amended by adding at the end thereof the following new paragraph:

"(17) Whenever a change in control of a state-chartered member or non-member bank that would require notice under paragraph (1) of this subsection occurs in a state that requires approval or lack of disapproval by a state banking supervisory agency under statutory provisions similar to those provided for in this subsection, as determined by rule or regulation by the appropriate Federal banking agency, the provisions of this subsection shall not apply."

Explanation of Amendment

This amendment would provide that, whenever the primary supervisory agency of a state-chartered bank has the right under state law provisions similar to those of the Change in Bank Control Act to approve or fail to disapprove acquisitions of insured banks, the Federal Deposit Insurance Corporation and Federal Reserve Board may not also require notice and the opportunity to disapprove the acquisition.

Need for the Amendment

This amendment is needed to short-circuit the present cumbersome dual approval process for changes in bank ownership in those 20 states that have change in bank control laws similar to or stronger than the Federal statute. At present, the approval process can take in excess of 6 months in these states, a time period during which changes in interest rates or in stock prices can materially alter the economic considerations affecting a bank acquisition.

TITLE III

ADMINISTRATION'S PROPOSAL OF PROVIDING REVENUE
BOND UNDERWRITING AND MUTUAL FUND SERVICE THROUGH
SECURITIES SUBSIDIARIES OF BANK HOLDING COMPANIES

The American Bankers Association believes that the securities subsidiary proposal suggested by the Administration would be unnecessarily cumbersome and expensive. As a result, it would limit competition for financial services. Title III of S. 1720 opens to large and small banks the opportunity to offer their customers mutual fund services and to participate in the underwriting of revenue bonds. Provision of these services themselves represents considerable commitments on the part of banks in terms of staff time and effort, legal and other expenses. The imposition of additional costs of establishing a subsidiary would effectively foreclose many non-money center banks from providing these services. Also, many banks would have to convert first to a holding company structure before establishing the subsidiary.

Additional costs include separate capital requirements and a duplicate corporate structure. Many banks are already under pressure from the regulators to increase their capital. To require separate capitalization of securities subsidiaries would exacerbate the capital shortage. Separate capitalization of subsidiaries is not the most productive use of funds. It is inefficient to require duplicate personnel when banks today have the trained and experienced personnel to provide these services. Also, to the extent a bank has branches it would be unable, without an additional set of subsidiary branches, to provide mutual fund and revenue bond underwriting services to its customers.

It is doubtful that many smaller institutions desiring only to sell mutual fund shares to customers would go to the trouble and expense of organizing a holding company and securities subsidiary for this purpose. In fact, even larger institutions question the financial efficiency and potential success of a separately capitalized subsidiary, which is limited to Treasury

and tax-exempt underwriting and mutual fund services.

Separation of a bank's securities activities into a subsidiary of a holding company provides no additional measure of protection for bank customers or depositors. It is true that securities services present a potential for conflicts-of-interest, but that potential exists in banking today and has over the years been subject to frequent close scrutiny. Not one of the several studies of conflicts-of-interest in banking, undertaken by such organizations as the House Banking Committee, the SEC and the Twentieth Century Fund, has found evidence of any real abuse. Placement of securities activities in a separate holding company subsidiary under common control with the bank adds no protection. Of course, it should be recognized that potential for conflicts-of-interest is not unique to banking. The securities industry also faces many potential conflicts, some of which are the same and others relate to the particular services they provide.

Section 301 of S. 1720, the underwriting section, contains specific conditions and prohibitions which resolve potential conflicts. The Administration is reported to have said that underwriting affiliates would be prohibited from selling revenue bonds to trust departments of banks owned by the same holding company. Section 301 of S. 1720 already prohibits a bank as fiduciary from buying from the bank as underwriter unless a court so directs. Bank mutual funds under Section 302, would be subject to the rules contained in the Investment Company Act, which set forth detailed restrictions on transactions between the fund and affiliated persons and also impose a fiduciary duty upon the investment adviser and underwriter to the fund. Of even greater significance are the obligations and liabilities placed upon banks by fiduciary law in the exercise of their fiduciary powers.

The segregation of bank securities activities into a separately capitalized subsidiary will, in fact, result in less protection for customers. Mutual fund and revenue bond customers would not have available to them the protection of the bank's capital. They could only look to the capital of the subsidiary.

The Administration's proposal reflects a less than full understanding of banking, the two services involved, and federal deposit insurance. The increased risk to banks from either or both of these services is non-existent or de minimis at most. Banks currently underwrite general obligation bonds and invest for their own account in revenue bonds as well as general obligation bonds. Banks have done so for generations without placing undue risk on depositors.

In addition, banks invest trust, guardianship, estate and some custody accounts individually and collectively. Banks invest agency accounts individually. Mutual funds are basically the same as investing agency accounts collectively. In all these instances the assets being invested belong to the customer and the risk of loss and reward of gain is the customer's not the bank's. The bank's role is that of fiduciary. The FDIC insurance does not apply to these fiduciary services of banks today.

In summary, based on the relatively few details disclosed thus far about the Administration's proposal, we feel that it imposes cumbersome and inefficient means of providing valuable customer services which cause needless additional expense, particularly in view of the fact that, though they would have to pay for it, bank customers and depositors would receive no additional protection as a result of the Administration's proposal.

TECHNICAL CORRECTION TO SECTION 302 OF S. 1720

Section 302 authorizing banks and other financial institutions to sponsor mutual funds contains a typographical error. The proposed new subsection (h)(3) of Section 22 of the Investment Company Act refers to the standards "prescribed under paragraph (1)(A) of this subsection" (See line 16, page 88 of S. 1720). It is not paragraph (1)(A) which prescribes the standards. They are contained in paragraph (1)(B). Thus on line 16 the reference to (1)(A) should be deleted and (1)(B) inserted in its place. This incorrect reference, which was carried into S. 1720 from Senator Chafee's S. 1424, should be corrected.

BANK HOLDING COMPANY INSURANCE ACTIVITIES-TITLE VI

Title VI would prohibit bank holding companies from engaging in insurance activities with the following exceptions:

- a. Credit life credit disability, and involuntary unemployment insurance would be permitted;
- b. Finance company subsidiaries would be permitted to sell up to \$10,000 of property insurance on loan collateral in general, and up to \$25,000 on mobile home loan collateral (both ceilings adjusted annually by the Consumer Price Index);
- c. General insurance agency activities would be permitted in towns of 5,000 or less population;
- d. Insurance activities engaged in or approved as of June 12, 1980 (Grandfather Date) would be permitted;
- e. Supervision of retail insurance agents selling fidelity, property and casualty, and group insurance to a bank holding company or its subsidiaries would be permitted;
- f. General insurance agency activities would be permitted for bank holding companies with total assets of \$50 million or less, except that sales of life insurance or annuities are restricted to limitations contained in a, b, and c, above (exemption ceases when assets exceed \$50 million).

Although the prohibitions in the bill are specifically designed to preserve the status quo with respect to insurance activities as of June 12, 1980, the amendments are wrong in principle:

1. There is no sound reason for expanding prohibitions in existing law, now administered by the Federal Reserve Board, and thereby diminishing legitimate competition to the ultimate disadvantage of consumers - Title VI is anti-competitive.
2. Statutory prohibition of a specific activity abandons sound public policy established in 1956 and affirmed in 1970. In formulating the 1970 Amendments to the Bank Holding Company Act, the Congress rejected the idea of placing specific statutory restrictions on the types of activities in which bank holding companies might engage. The Board of Governors of the Federal System was delegated authority to define activities "so closely related to banking as to be a proper incident thereto " The Board has exercised its authority in a deliberate, responsible way. The Board's reasons for approving certain types of activities while rejecting certain other types of activities have been set forth in detail in administrative orders and in statements submitted on previous occasions to committees of the Congress.
Nothing has occurred since 1970 to warrant a change in this policy.

3. Banks and bank holding companies are now prohibited by law from "tie-in" sales activities, i.e., linking an extension of credit to the sale of any other banking service, including the sale of insurance. "Tie-ins" are unlawful under both the anti-trust laws and Section 106 of the 1970 amendments to the Bank Holding Company Act. Even if they were lawful, "tie-ins" would be questionable business practice.
4. Bankers have repeatedly come before the Congress to argue against government intervention in banking and the mounting burden of regulation, to argue for liberalization of existing laws and regulations, and to urge that greater latitude be provided for the working of market forces in the banking and financial system. There appears to be a growing recognition in the Congress that the public interest would be served by less rather than more regulation. Title I is contrary to this progressive trend, and should not be enacted.
5. The consistent posture of bankers is that increased competition should be accommodated by removing restrictions that impose competitive disadvantages on banks. Our membership has again and again indicated that they are not seeking protection from competition but are seeking a more level playing field on which to compete with themselves, with other types of financial institutions, and with other less regulated kinds of business.

If bank holding companies are to be restricted in their insurance activities, the same restrictions should be applied to savings and loan holding companies. Likewise, since existing law prohibits "Tie-in" sales by banks and bank holding companies, the same prohibitions should be applied to savings and loan associations and savings and loan holding companies.

Language for these amendments and justification for their acceptance are as follows:

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 • LIMITATIONS ON INSURANCE ACTIVITIES
 OF SAVINGS AND LOAN HOLDING COMPANIES

AMENDMENT TO TITLE VI

At the appropriate place add the following new section:

"Sec. That section 408 (c) of the National Housing Act, as amended (12 U.S.C. 1730a) is hereby amended by striking out the word "and" at the end of paragraph (1), by changing the period at the end of paragraph (2) to a semicolon, by adding the word "and" at the end of paragraph (2), and the following new paragraph at the end thereof:

"(3) notwithstanding any other provisions of this section, no savings and loan holding company or subsidiary thereof shall provide insurance as a principal, agent, or broker except (A) where the insurance is limited to assuring repayment of the outstanding balance due on a specific extension of credit by a savings and loan holding company or its subsidiary in the event of the death or disability of the debtor; (B) any insurance agency activity in a place that (i) has a population not exceeding five thousand (as shown by the last preceding decennial census), or (ii) the savings and loan holding company, after notice and opportunity for a hearing, demonstrates it has inadequate insurance agency facilities; (C) any insurance agency activity that was lawfully engaged in by a savings and loan holding company or any of its subsidiaries on July 31, 1980; (D) any insurance activity where the activity is limited solely to supervising on behalf of insurance underwriters the activities of retail insurance agents who sell (i) fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the savings and loan holding company or any of its subsidiaries, and (ii) group insurance that protects the employees of the savings and loan holding company or any of its subsidiaries; or (E) any insurance agency activity engaged in by a savings and loan holding company, or any of its subsid-

aries, which savings and loan holding company has total assests of \$50,000,000 or less: Provided, however, that such savings and loan holding company and its subsidiaries may not engage in the sale of life insurance or annuities except as provided in subparagraph (A) or (B)."

Explanation of Amendment

This amendment would apply the limitations of the activities of bank holding companies now contained in H.R. 2255 to savings and loan holding companies. Under the amendment's provisions, savings and loan holding companies would be prohibited from engaging in insurance activities except in certain defined circumstances, such as the sale of credit life, health, or accident insurance, where the insurance activities are traditionally closely related to savings and loan activities. The amendment would also grandfather all savings and loan insurance activities engaged in by holding companies on July 31, 1980.

Need for the Amendment

This amendment is needed because savings and loan holding companies may, under existing law, engage in a broad range of insurance activities in direct competition with banks and independent insurance agents. The market strength of savings and loan holding companies is, in many markets, no less than that of bank holding companies so that the same concerns with respect to bank holding companies which gave rise to Title I of H.R. 2255 apply equally to savings and loan holding companies.

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PROHIBITION OF "TIE-IN" SALES BY SAVINGS AND LOAN
ASSOCIATIONS AND S & L HOLDING COMPANIES

Amendment to Title VI

At the appropriate place add the following new section:

Definitions

Sec. As used in this section, the terms "insured institution," "savings and loan holding company," and "subsidiary" have the meaning ascribed to such terms in section 408 (a) or the National Housing Act. For purposes of this section only, the term "company" as used in section 408 (a) of the National Housing Act means any person, estate, trust, partnership, corporation, association or similar organization, but does not include any corporation the majority of the shares of which are owned by the United States or by any State. The term "trust service" means any service customarily performed by a savings and loan trust department. The term "Corporation" means the Federal Savings and Loan Insurance Corporation.

Tie-in arrangements

(b) An insured institution shall not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition or requirement--

- (1) that the customer shall obtain some additional credit, property, or service from such insured institution other than a loan, discount, deposit, or trust service;
- (2) that the customer shall obtain some additional credit, property, or service from a savings and loan holding company of such insured institution, or from any other subsidiary of such savings and loan holding company;
- (3) that the customer provide some additional credit, property, or service to such insured institution other than those related to and

usually provided in connection with a loan, discount, deposit, or trust service;

(4) that the customer provide some additional credit, property, or service to a savings and loan holding company of such insured institution, or to any other subsidiary of such savings and loan holding company; or

(5) that the customer shall not obtain some other credit, property, or service from a competitor of such insured institution, a savings and loan holding company of such insured institution, or any subsidiary of such savings and loan holding company, other than a condition or requirement that such insured institution shall reasonably impose in a credit transaction to assure the soundness of the credit.

The Corporation may by regulation or order permit such exceptions to the foregoing prohibition as it considers will not be contrary to the purposes of this section.

Judicial proceedings

(c) The district courts of the United States have jurisdiction to prevent and restrain violations of subsection (b) of this section and it is the duty of the United States attorneys, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations. The proceedings may be by way of a petition setting forth the case and praying that the violation be enjoined or otherwise prohibited. When the parties complained of have been duly notified of the petition, the court shall proceed, as soon as possible, to the hearing and determination of the case. While the petition is pending, and before final decree, the court may at any time make such temporary restraining order or prohibition as it deems just. Whenever it appears to

the court that the ends of justice require that other parties be brought before it, the court may cause them to be summoned whether or not they reside in the district in which the court is held, and subpoenas to that end may be served in any district by the marshal thereof.

Subpoenas in actions by United States

(d) In any action brought by or on behalf of the United States under subsection (b), subpoenas for witnesses may run into any district, but no writ of subpoena may issue for witnesses living out of the district in which the court is held at a greater distance than one hundred miles from the place of holding the same without the prior permission of the trial court upon proper application and cause shown.

Civil actions

(e) Any person who is injured in his business or property by reason of anything forbidden in subsection (b) may sue therefor in any district court of the United States in which the defendant resides or is found or has an agent, without regard to the amount in controversy, and shall be entitled to recover three times the amount of the damages sustained by him, and the cost of suit, including a reasonable attorney's fee.

Injunctions

(f) Any person may sue for and have injunctive relief, in any court of the United States having jurisdiction over the parties, against threatened loss or damage by reason of a violation of subsection (b), under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity and under the rules

governing such proceedings. Upon the execution of proper bond against damages for an injunction improvidently granted and a showing that the danger of irreparable loss or damage is immediate, a preliminary injunction may issue.

Limitation of actions

(g)(1) Subject to paragraph (2), any action to enforce any cause of action under this section shall be forever barred unless commenced within four years after the cause of action accrued.

(2) Whenever any enforcement action is instituted by or on behalf of the United States with respect to any matter which is or could be the subject of a private right of action under this section, the running of the statute of limitations in respect of every private right of action arising under this section and based in whole or in part on such matter shall be suspended during the pendency of the enforcement action so instituted and for one year thereafter: Provided, that whenever the running of the statute of limitations in respect of a cause of action arising under this section is suspended under this paragraph, any action to enforce such cause of action shall be forever barred unless commenced either within the period of suspension or within the four-year period referred to in paragraph (1).

Actions under other Federal or State laws

(h) Nothing contained in this section shall be construed as affecting in any manner the right of the United States or any other party to bring an action under any other law of the United States or of any State, including any right which may exist in addition to specific statutory authority, challenging the legality of any act or practice which may be proscribed by this section. No regulation or order issued by the Corporation under this section shall in

Estate Settlement Procedures Act. In some instances, the two laws require the same information to be presented in different ways.

The time has come for Congress to recognize that Truth in Lending disclosures are not-compatible with first mortgage loans. We urge this Committee, in considering an exemption for real estate brokers, to recognize that a broader problem exists. We urge this Committee to begin a review of all disclosure laws as they relate to first mortgage loans with a view to exempting these loans from the Truth in Lending law.

Section 704: Section 704 addresses a problem that has plagued lenders for some time. This section would provide that the Truth in Lending disclosure law would preempt all similar state laws. This represents a change that the Association has long supported and continues to support. However, the addition of a provision which allows states complete authority to override the federal disclosure law by specific legislative enactment is alarming and counterproductive.

This additional provision would destroy the uniformity in disclosures that the Truth in Lending law was designed to promote. States would be free to eliminate disclosures such as "annual percentage rate" which have been designed to assure national uniformity. States could treat charges in various ways with the result that disclosures could have differing and confusing meanings in different states.

TITLE VII - MISCELLANEOUSTruth in Lending

Section 703: Section 703 is designed to eliminate disclosure obligations for "arrangers of credit" including real estate brokers who arrange credit for home buyers.

The Association feels that the problems associated with disclosures in real estate transactions should be addressed in a broader context. The same policy considerations that would support exempting real estate brokers, mainly the compliance burden when compared to consumer benefit, also support an exemption for all creditors making first mortgage loans.

The Truth in Lending disclosures (most notably the APR) have never gained the wide acceptance by the general public in residential mortgage transactions as they have in general consumer credit transactions. In a mortgage transaction a consumer is concerned about simple interest rates and points. An annual percentage rate is not generally used in shopping for real estate credit, and has little meaning to most shoppers.

As a result, the Truth in Lending Act has resulted in a compliance burden for creditors with no corresponding consumer benefit. In fact, the Truth in Lending disclosures often introduce an element of confusion to mortgage transactions. For example, Truth in Lending disclosures may duplicate, in part, disclosures required under the Real

Estate Settlement Procedures Act. In some instances, the two laws require the same information to be presented in different ways.

The time has come for Congress to recognize that Truth in Lending disclosures are not compatible with first mortgage loans. We urge this Committee, in considering an exemption for real estate brokers, to recognize that a broader problem exists. We urge this Committee to begin a review of all disclosure laws as they relate to first mortgage loans with a view to exempting these loans from the Truth in Lending law.

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We urge the Committee not to give states the authority to exempt themselves from the Truth in Lending law. The result of such action would be increased rather than decreased compliance burdens. Nonuniformity in disclosures with attendant consumer confusion would result, frustrating one major purpose of the Truth in Lending Act, namely to permit the public a meaningful way to comparison shop for credit.

The most desirable approach to federal preemption from both a creditor and consumer standpoint is a complete federal preemption of all state disclosure laws. Such an approach would recognize the creditor's need for certainty as to the effect of the federal or state law. Such an approach would also provide consumers with a nationally uniform disclosure.

- The Truth in Lending Simplification and Reform Act was passed only after long careful deliberation as to what level of disclosures were in the consumer's best interest. Congress, mainly through the diligent efforts of this Committee, attempted to carefully balance the consumers need for specific disclosures with the need to avoid "information overload". While this Association does not recognize the present law as perfect or even desirable, we believe it is inconsistent for Congress to determine the proper balance and then to allow inconsistent state laws to upset that balance.

Congress has determined what disclosures consumers need to make informed credit choices and that those disclosures should be made in a consistent and uniform manner by all creditors. By making this determination, Congress has also determined that additional disclosures are not in the best interests of consumers. Congress has, in effect, determined to entirely occupy this legislative field. There should be no need for additional state legislative action addressing the same problems. Accordingly, the Association strongly recommends that the proposed new subsection (b) to Section 111 of the Truth in Lending Act be eliminated.

Without a rational, clear, specific preemption standard, the creditor gains little if anything by simplification of disclosure requirements. Consumers are deprived of the simplified more meaningful disclosure statements contemplated by Congress. We urge the Committee's careful attention to the adoption of a new absolute preemption standard as reflected in the proposed amendment to Section 111(a) of the Truth in Lending Act. We strongly oppose the broad authority given to states in the proposed Section 111(b).

Section 705: Section 705 would eliminate the minimum statutory liability of \$100, increase the maximum statutory liability from \$1,000 to \$5,000, and provide that such penalties would be awarded only if the creditor were in substantial noncompliance with the requirements of this

title. The amendment also lists a number of factors that would be considered by the court in determining the amount of statutory penalties imposed.

The Association strongly supports adoption of a limiting test. However, we have some concern about how this particular limiting test, "substantial noncompliance", would be applied. We presume this test is meant to be applied on a transaction by transaction basis. In other words, if a creditor had made a good faith attempt to comply with the disclosure rules in the transaction under consideration, no civil liability would apply.

However, the standard could be interpreted in another way. For example, a plaintiff may assert and the court find that every contract and disclosure statement written by a defendant creditor contained the same technical or hypertechnical violation. Based upon such a finding a plaintiff may then assert that, since every one of the creditor's contracts or disclosure statements contained a violation, the creditor was in substantial noncompliance.

In light of this possible interpretation, the Association recommends that a "good faith" test be substituted for the "substantial noncompliance" test. A creditor should have immunity from civil liability if the creditor can demonstrate a good faith effort to comply with the requirements of the act. Application of this test on a portfolio basis would not have the potential disastrous results of the "substantial noncompliance" test.

We suggest that the proposed subparagraph B of section 130(a)(2) be amended to read as follows:

"(B) the creditor has not made a good faith effort to comply with the requirements of this title,...

The Association strongly endorses the elimination of the minimum statutory penalty of \$100. The Association has previously recommended that all statutory penalties be eliminated. The statutory penalty provisions have been an incentive to nonmeritorious litigation. The majority of Truth in Lending law suits are unrelated to any effort to insure proper consumer protection.

For the reasons that we have proposed that all statutory penalties be eliminated, we oppose the increase of the maximum penalty to \$5,000. While the effect of this increase would be substantially mitigated by the addition of a "good faith" compliance test or the proposed "substantial noncompliance" test (if it is interpreted on a transaction by transaction basis), we see no need for increasing the penalty. An increase in statutory penalties would serve to encourage nonmeritorious litigation unrelated to the essential purposes of the law.

Section 706: Section 706 would extend for six months the optional effective date of the changes required by the Truth in Lending Simplification and Reform Act. We strongly support this extension.

In spite of the best effort possible, the Federal Reserve Board staff has just recently been able to publish its Commentary interpreting the new Regulation Z. This

Commentary of over 150 pages is crucial to form development and other compliance efforts. Consequently, creditors have waited for this Commentary in order to insure that their compliance efforts are in accordance with its provisions. The new law has required a change in every closed-end contract form and in virtually all open-end disclosure forms. Creditors need an additional six months in order to have the full year contemplated by Congress to implement the numerous changes.

FINANCIAL INSTITUTIONS RESTRUCTURING AND SERVICES ACT OF 1981

WEDNESDAY, OCTOBER 21, 1981

**U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.**

The committee met at 9:30 a.m., in room 5302 of the Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Proxmire, Heinz, and Sarbanes.

The CHAIRMAN. The committee will please come to order. This morning we are happy to have a panel of expert witnesses before us: Edwin Brooks, legislative vice chairman, U.S. League of Savings Associations; James A. Coles, treasurer, National Savings and Loan League; Robert Masterton, chairman, National Association of Mutual Savings Banks; John R. Wood, president, National Association of Realtors; Mark Riedy, executive vice president, Mortgage Bankers Association of America; and James Shimberg, chairman, Mortgage Finance Committee, National Association of Home Builders. Gentlemen, we are glad to have all of you with us this morning, and would start with Mr. Brooks.

STATEMENT OF EDWIN B. BROOKS, JR., LEGISLATIVE VICE CHAIRMAN, U.S. LEAGUE OF SAVINGS ASSOCIATIONS; JAMES A. COLES, TREASURER, NATIONAL SAVINGS AND LOAN LEAGUE; ROBERT R. MASTERTON, CHAIRMAN, NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS; MARK J. RIEDY, EXECUTIVE VICE PRESIDENT, MORTGAGE BANKERS ASSOCIATION OF AMERICA; AND JAMES SHIMBERG, CHAIRMAN, MORTGAGE FINANCE COMMITTEE, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. Brooks. Thank you, Mr. Chairman. I am Edwin B. Brooks, Jr., president of Security Federal Savings and Loan Association of Richmond, Va. I appear today on behalf of the U.S. League.

We commend you, Mr. Chairman, both for your approach to financial institution legislation in this 97th Congress, and for the content of S. 1720, the Financial Institutions Restructuring and Services Act.

As I am sure you understand, we have some reservations and suggestions for portions of S. 1720. It is overall a great beginning for the process of modernizing the laws which govern our association.

Furthermore, we believe you are correct to approach the task in a comprehensive manner, rather than isolate requests for emergen-

cy powers from the fundamental changes needed to broaden and assure the continued service of our institutions to our community.

We are particularly pleased that your legislation addresses the growing problem of State interference with the exercise of due-on-sale clauses. In this regard, S. 1720 is more desirable than the bill submitted by Chairman Pratt and the administration. State-imposed limits on due-on-sale perpetuate the unprofitable loans in our portfolios made years ago in the expectation that the Government could control inflation, and in periods of reasonable interest rates. To prevent the rollover of these loans when properties are sold greatly handicaps our chances of working out from under our portfolio so we may pay the rates desired by our savings customers.

Another important addition you have made to the bill sent up by Chairman Pratt is an increase in FSLIC and FDIC insurance coverage for retirement savings accounts. Frequently customers wish to enter the IRA program following early retirement or when pension plans are terminated where they work. These depositors often wish to deposit amounts at or near the present \$100,000 ceiling. IRA and Keogh accounts invite systematic additions annually in amounts as high as \$15,000 for self-employed Keogh participants under the new tax law—thus these accounts of 10 grow rapidly and may exceed \$100,000 in just a few years. This is an excellent and stable source of funds for home finance—provided, of course, that the costs are reasonable. An increase in the \$100,000 ceiling is overdue for these accounts.

The more flexible asset and liability powers are welcome, but I must emphasize two points first. No one should be misled into thinking that the grant of new powers can solve our immediate problems of high-interest rates, asset-liability imbalance, and negative earnings. They cannot. Many of these new authorities will take years before the benefits are realized. Second, while these changes in the law governing financial institutions allow us latitude to pursue other activities and develop profit centers to sustain our institutions when interest rates are hostile, the tax laws still act to assure that we will continue our residential finance specialty.

We recommend that two powers contained in the early drafts of the Pratt bill—that are omitted in the product submitted to you for introduction—be restored. These are a “prudent man” or leeway authority, and a 10-percent category for direct investment in real estate.

Our major reservation with S. 1720 concerns the potential invitation to bank and bank holding company takeovers of S. & L.'s. Certainly the Home Loan Bank Board has demonstrated in recent weeks its ability to deal with problem situations within the framework of FSLIC-insured institutions. Statutory authority for bank acquisitions of S. & L.'s—even as a supervisory matter, would lead, we fear, to cherry picking by money center banks of choice locations, or perhaps expeditions to find a back-door route around the McFadden Act. Furthermore, after the expansionary appetites of a few big banks are satisfied, we believe the FSLIC and FDIC would still find themselves in a desperate search for partners.

Finally, I would like to emphasize, as our prepared statement does, and, Mr. Chairman, we will have that on file, which is a longer statement—

The CHAIRMAN. The entire statements will be placed in the record.

Mr. BROOKS. Thank you, sir.

RUNAWAY DIDC

We want to emphasize the importance of committee action to bring the runaway Depository Institutions Deregulation Committee [DIDC] under control. The recent decision to increase passbook savings rates, now apparently rescinded, is just one of many irresponsible actions by the DIDC.

Considering the current level of interest rates, which have been punishing our institutions and the Nation's consumers all year and leading to the collapse of the housing sector, we simply cannot understand how the DIDC can plot to remove rate ceilings and accelerate the process of savings deregulation. This is no time to invite rate wars among financial institutions, as the deregulators have done by creating a new, "wild card" or ceiling-free 18-month retirement savings instrument to take effect December 1.

By its actions to date, the DIDC has abused the confidence placed in it to conduct an orderly phaseout of interest rate ceilings over 6 years consistent with the safety and soundness of financial institutions. The courts have agreed in two suits brought by the U.S. League as the result of past abuses.

Our prepared statement recommends four amendments to reconstitute the DIDC and give it some guidance. We would hope those changes could be added during the legislative process to S. 1720 or other appropriate legislation. In the meantime, we ask the help of the committee in urging the present DIDC to "take a time out" and refrain from implementing the reckless deregulation steps adopted and proposed on September 22.

Again, Mr. Chairman, you have our thanks for taking the lead with a meaningful legislative package for financial institutions. We wish you success.

Thank you, sir.

[The complete statement follows:]

STATEMENT OF EDWIN B. BROOKS, JR.
TO THE SENATE COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS

October 21, 1981

MR. CHAIRMAN:

My name is Edwin B. Brooks, Jr. I am President of Security Federal Savings and Loan Association of Richmond, Virginia and appear today on behalf of the United States League of Savings Associations*, where I serve as Legislative Vice Chairman and Immediate Past President.

The U.S. League welcomes this opportunity to present its views on S. 1686, S. 1703, S. 1720 and S. 1721.

We commend you, Mr. Chairman, for approaching the conditions facing our nation's depository institutions in a comprehensive manner. This is preferable, we believe, to isolating the request of the regulators for emergency assistance powers from the statutory changes needed to broaden and assure the continued service of savings and loan associations to their communities.

*The U.S. League of Savings Associations has a membership of 4,400 savings and loan associations representing over 99% of the assets of the \$625 billion savings and loan business. League membership includes all types of associations -- Federal and state-chartered, stock and mutual. The principal officers are: Rollin Barnard, President, Denver, CO; Roy Green, Vice President, Jacksonville, FL; William B. O'Connell, Executive Vice President, Chicago, IL; Arthur Edgeworth, Director-Washington Operations; Glen Troop, Legislative Director; and Phil Gasteyer, Associate Director-Washington Operations. League headquarters are at 111 E. Wacker Dr., Chicago, IL 60601. The Washington Office is located at 1709 New York Ave., N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

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Mr. Chairman, our testimony today will discuss various provisions in your Depository Institutions Insurance and Services Act (S. 1720) as well as the Thrift Institutions Restructuring Act (S. 1703) developed by Federal Home Loan Bank Board Chairman Pratt, and introduced by you at his request. There are additional and related legislative changes we are recommending -- particularly with regard to the abuse of the discretion vested by the Congress in the Depository Institutions Deregulation Committee under P.L. 96-221, and some investment authorities and other revisions omitted during the process of review within the Administration prior to the introduction of S. 1703. We will also comment briefly about the Federal Deposit Insurance Consolidation Act (S. 1721) and Senator Lugar's legislation (S. 1686) to enable governmental units to use NOW accounts and receive a better return on short-term surplus funds.

The Committee is well aware of the problems which beset the thrift industry: a prolonged period of high interest rates; an investment portfolio filled with long-term, low-yielding home mortgages -- two-thirds of which return less than 10%; a dramatic shift over the past three years to market-related savings, with almost two-thirds following today's 14%, 15%, and 16% rates; \$20 billion in deposit outflows in the first eight months of the year; negative earnings for the vast majority of institutions; a record pace of mergers and consolidations (including seven supervisory situations); home loan originations at less than half normal activity. Well-documented, too, are the consequences for other participants in our economy when mortgage credit is unavailable or prohibitively costly from specialized savings and loan associations: housing

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starts at post-war lows; unemployment approaching 16½ in the construction trades; real estates sales at half their normal activity; mill closings in the forest products industry; growing concern by other manufacturers and retailers with goods which go into homes. While President Reagan observes that our economy is now in a recession, a depression is, perhaps, the best way to characterize the housing sector.

The Senate demonstrated its sympathy to these problems, in part, by enacting the All Savers Tax Act -- now in effect for three weeks. (Let me interject my thanks to you, Mr. Chairman, and the many Members of this Committee who supported that effort.)

The Performance of the DIDC

However, the promise of relief to our institutions through lowered cost of funds as a result of All Savers has now been undermined ... perhaps nullified in some cases ... through the latest activity of the Depository Institutions Deregulation Committee (DIDC).

Despite the repeated warnings of Chairmen Volcker and Pratt (see Addendum A); a majority of the DIDC ignored your statutory admonition to consider the due regard for the safety and soundness of institutions at their meeting September 22.

The DIDC approved a 1/2 of 1½ increase in regular (passbook) savings account ceilings -- which, if implemented, amounts to an instantaneous \$500 million "hit" on the earnings of our institutions -- and with no prospects whatsoever for attracting additional deposits or customers. With the announcement of a belated switch in Secretary Regan's vote last Friday, that action has now been put "on hold" -- for which we are grateful.

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Still in place, however, are final rules (for implementation December 1) for a new, ceiling-free, 18-month account for IRA/Keogh customers. The market for these retirement savings has been greatly expanded as a consequence of the Tax Reduction Act. These new tax-deferred, "wild card" accounts are expected to cost financial institutions substantially more than the passbook rate hike. The prospect of unlimited bidding for these funds and the reasonable expectation of significant transfers from existing IRA/Keogh customers argues for substantial cost-of-funds increases.

Another costly, though somewhat esoteric, decision at the September 22 meeting will permit a ceiling for the popular Money Market Certificates each week based on a four-week average. If in effect heretofore, this new provision would have cost savings associations \$300 million in the first eight months of 1981. While the averaging would have permitted slightly higher ceilings in weeks where MMC rates declined, they still would have been well below rates offered by money market fund competition -- thus raising the question (as in the passbook hike) whether such a change will assist materially in holding deposits.

While rushing ahead with the changes just described -- and publishing for 30-day comment (rather than the customary 60 days) additional "wild card" certificate, money-fund, and fast phase-out proposals, as well -- the DIDC refused once again on September 22 to consider restoration of a housing differential on the Money Market Certificate Accounts (MMC). Restoration of the differential on this most-popular savings category was first denied to housing lenders at the Committee's first meeting on May 28, 1980 -- discussed at oversight hearings

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by your Committee a year ago. In its absence, MMC deposits continue to shift away from housing-specialized thrift institutions toward commercial banks. Not only would a differential on MMCs hold deposits ... it would reduce costs as institutions reduce their reliance on more expensive outside borrowings and Federal Home Loan Bank System advances to maintain liquidity.

We continue to urge the DIDC to restore (and, where appropriate, maintain) the thrift differential for one very simple reason: it responds to the most pressing liquidity pressures on the business -- and at no cost to the Federal Government. If the return of a housing differential impacts smaller commercial banks (and therefore credit for home town business and agriculture) adversely, the DIDC could permit, as they did in May 1980, MMC rollovers at the thrift rate or extend the differential to banks invested significantly in housing.

By its actions to date, the DIDC has abused the confidence the Congress placed in it to conduct an orderly phase-out of interest rate ceilings over six years. The courts have agreed in two different suits brought by our organization: the first holding that proper administrative procedures were ignored; and the latest invalidating an accelerated phase-out schedule adopted last June. Addendum B quotes from these various judicial decisions.

The procedural laxity continues, by the way. Without the participation of the voting DIDC members, the staff as a "technical matter" reversed an earlier announcement and opened the door for brokerage house marketing of All Saver Certificates on October 1. Securities firms are clearly not among the "qualified institution"

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All Savers issuers recited in the Tax Reduction Act, reflecting the interest of many in Congress to provide a savings source which could support home town residential and agricultural credit needs.

(We have written the DIDC asking for formal consideration of the issues raised by the staff interpretation.)

The performance to date of the DIDC has contributed, as well, to a shift in the competitive balance among depository institutions. Commercial banks enjoyed three times as much retail deposit savings growth as savings and loan associations between May 1980 and June 1981 (latest figures available). More significantly, large commercial banks are experiencing record profitability. Table 1 shows some of the early returns for the third quarter of 1981 and for the first nine months of this year.

In the Deregulation Act, Congress gave the DIDC six years to accomplish complete deregulation of savings rates. If their actions of the past 18 months are a taste of what is to come, I hate to think what further damage the DIDC will do the depository institutions and the American economy in the remaining 4-1/2 years.

We strongly urge this Committee, as part of your work on a comprehensive financial institutions package, to take corrective action regarding the DIDC before the DIDC wrecks, first, the thrift industry, and second, the commercial banks which provide home town credit for small business and agriculture across America.

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In particular we propose four amendments to Title II of P.L. 96-221, the "charter act" for the DIDC:

§- Reconstituting the Committee to represent the agencies responsible for commercial banks, savings banks and savings and loan associations, and the "lender of last resort" -- that is, a Committee consisting of the Chairmen of the Federal Reserve, Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board; as an alternative, since the Comptroller is a member of the FDIC Board, the Comptroller and FDIC Chairman might share one of the three votes; majority vote would prevail;

§- Specifically instructing the DIDC not to exceed market rates of interest in accomplishing deregulation, defined as "the rate equal to the coupon equivalent yield on United States Treasury Securities of comparable maturity and size;"

§- Provide an opportunity for the Congress to review final rules of the DIDC; if one House disapproves within 45 days such rule could not take effect;

§- And, amending the Directive to the Committee (Section 204) to require specific findings that decisions do not materially increase the insurance risk to the FDIC and FSLIC; reduce the availability of consumer, agricultural or mortgage credit; and that DIDC actions do not significantly affect safety and soundness.

These statutory recommendations would prevent the most flagrant abuses of discretion by the DIDC in the future. But, given the precarious situation at many financial institutions, it is apparent that the September 22 actions and proposals pose an immediate threat to the stability of our depository system.

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Therefore, we would also recommend strongly that the Members of this Committee urge the DIDC to refrain from further implementation while Congress has your comprehensive legislation under active consideration. Apparently, a majority of the DIDC now recognizes that the 1/2 of 1 percent passbook increase on November 1 would have been, in the words of Treasury Secretary Regan, "unnecessary and even counterproductive"; the four-week averaging for MMCs and, especially, the invitation to a wild-card bidding war for IRA/Keogh deposits, are even more so. The prospect for still faster ... and uncharted ... deregulation from the proposals issued for consideration at the December 16 meeting underscores the need for the DIDC to "suspend work" pending Congressional oversight and direction.

Our protest against the performance of the DIDC is, to a significant degree, a matter of timing and adherence to a six-year program for deposit deregulation. We do not challenge the public's desire for a market return on their savings when committed to true capital formation. But savings and loan associations are ill-equipped to accelerate the pace of liability deregulation -- as, we feel, the 96th Congress recognized by establishing an extended phase-out period. If shorter-term investment opportunities and variable-rate mortgages had arrived in June 1978, while liability deregulation began in earnest in April 1981 ... rather than vice versa, the actual sequence ... then associations might be far better prepared for a faster deregulation schedule. And if yield curves had been rightside up, rather than upside down, our earnings distress would not cloud the prospects for a confident future and a general economic recovery, as it does today.

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We cannot predict, of course, the ultimate success of our National Economic Recovery Program. That is why it is so important to begin as soon as possible to modernize the laws which govern our activities. In that regard, Mr. Chairman, your two bills pending today, S. 1703 and S. 1720, are a great beginning.

Broader Powers for Thrift Institutions

Any discussion of broadened investment powers for savings and loan associations must begin with a reminder: the changes recommended in S. 1703 and S. 1720 only affect the statutes within the jurisdiction of your Banking Committee. The tax laws also determine the investment activity of our institutions; as long as the eligibility for Section 593 tax treatment depends upon predominant investment in qualifying real property loans (currently 82%), our institutions will remain the residential home finance specialists for American families. It is vital, however, that the financial institution laws allow, as a statutory matter, increased latitude to pursue other activities and develop profit centers to sustain and compliment our housing specialty when the interest rate cycles turn hostile for longer-term commitment.

Title II of S. 1703 and Part B of the first title of S. 1730 provide a number of needed improvements to the investment powers of Federally-chartered savings associations: removal of percentage-of-asset, loan-to-value, and first-lien restrictions on real property loans; a workable overdraft loan authority for demand accounts; authority for commercial, corporate, business and agricultural lending (subject to the same loan-to-one-borrower limits applicable to national banks); an opportunity to invest in tangible personal property

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and engage, thereby, in equipment leasing; removal of asset limitations on municipal and corporate debt, and commercial paper purchases; clarification of authority to offer inventory financing as a necessary adjunct to the consumer loan powers granted last year (but under-utilized to date); modest expansion of service corporation investment in so-called "second-tier" corporations; clear authority to joint venture with investment firms capable of purchasing portions of low-yielding portfolios; and, an ability to develop thrift correspondent relations through investment in time and savings deposits of other savings associations, not just commercial banks.

We were disappointed that two provisions contained in early drafts of the Federal Home Loan Bank Board's recommended legislation do not appear in either S.1703 or S. 1720.

The first would have permitted a 10%-of-assets authority for direct investment in real estate (including equity positions). Not only can this be a profitable investment opportunity, but direct real estate investment can provide the background authority for new financing alternatives appealing to institutions and their customers. In a number of jurisdictions, this authority is needed by Federally-chartered S&Ls to achieve parity with their state-chartered competitors. We understand that the Treasury Department objected to this provision on the grounds that it exceeded real estate investment powers available to national banks; we have no objection to a comparable change in the banking laws. (For that matter, we do not see why the nation's real estate financing specialists, savings and loan associations, should be governed by strict parity with real

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estate powers which happen to be found in the banking statutes.)

Finally, direct investment authority already exists for service corporations of Federal S&Ls; there is no logical reason to deny it to the parent association.

The second omission is an adequate "leeway" power as found, for example, in the laws governing Federally-chartered credit unions. Such powers, of course, give flexibility for business opportunities not found -- for one reason or another -- elsewhere in the Home Owners' Loan Act. The very limited authority available under present law is restrained by language limiting its use to investments primarily for residential and agricultural purposes. An increase to 10%-of-assets without designation is not unreasonable considering our rapidly changing financial world. The Home Loan Bank Board would set rules for exercise of any leeway authority.

Direct investment in real estate to 10%-of-assets and a "leeway" authority of similar size would be useful additions to the other powers enumerated in S. 1703 and S. 1720.

We have also reviewed those sections of the bills (Section 214 of S. 1703; Section 134 of S. 1720) which equate establishment or retention of interstate branches with an association's bad debt reserve tax deduction.

The sections would require, as a practical matter, that out-of-state branches (taken together) separately meet the tax code definition of a domestic building and loan.

We are opposed to this limitation for several reasons. First, it appears to frustrate the very purpose of the asset-improvement sections of this legislation. The incongruous result will be modern, diversified thrifts with broad new asset powers within the state of original operation with branch

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networks operating without new powers -- potentially dragging down earnings and reserves.

Second, the language imposes significant monitoring problems. Instead of treating each branch as part of a whole entity, the out-of-state branches will have to be controlled and supervised individually.

Finally, the result, at least from a public point of view, will be confusing: e.g., "Yes, you can get a small business loan from First Federal in Ohio but not from its branch in Kentucky".

We wish to remind the Committee that while we have not actively sought interstate mergers as a solution to our difficulties, we cannot support a plan which would give birth to a bifurcated system of savings and loan operations.

Section 215 of S. 1703 (Section 135, S. 1720) unduly penalizes savings and loan members of certain holding companies. In this case, the penalty takes the form of restricting unitary savings and loan holding companies to the limited activities authorized for multiple savings and loan holding companies if the insured subsidiary fails to meet the definition of a domestic building and loan contained in the tax code.

We are opposed to this approach for the reasons stated above: it conflicts with, and penalizes use of, the fundamental asset shortening/broader power purposes of this comprehensive legislative modernization. However, in the case of a holding company it also could prohibit any manufacturing or industrial

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company from owning or continuing to own a savings and loan since their activities (steel manufacturing, for example) would not be on the multiple savings and loan holding company activities list -- thereby forcing divestitures. Since we do not view acquisition of thrifts by non-financial entities as anti-competitive (indeed it may help to preserve competition) we would suggest that this provision be removed from the bill.

If savings and loan associations are to compete in a substantially deregulated marketplace for savings it is important that they have a broader range of funds acquisition tools. In comparing commercial banks and savings associations, researchers often overlook the stable and less-costly (non-interest bearing) checking account base enjoyed, as a monopoly, by commercial banking. The lack of demand account authority at S&Ls is particularly disadvantageous in serving customers from such allied fields as real estate brokerage and home building.

The NOW accounts provided nationwide for thrift institutions last year -- limited as they are to individuals and non-profit entities -- do not satisfy the full-service requirements of modern financial institution relationships with customers. Indeed, Federal Reserve figures indicate that since the arrival of NOW accounts nationwide, savings and loan associations have captured only 10% or so (in dollar terms) of the "other checkable deposit" market, and, of course, are precluded from providing demand deposit services for businesses. Section 103 of both bills corrects this deficiency. The statutory (though never exercised) notice period for NOW accounts -- now 30 days -- would also be adjusted to 14 days in line with commercial banking (and Federal Reserve) practice.

Preemption of State Laws Preventing Exercise of Due-On-Sale

A major threat to the prospects today for modernization of low-yielding thrift loan portfolios is the increasing number of jurisdictions which, by statute or judicial decision, prevent the enforcement of due-on-sale clauses contained in mortgage contracts. Such agreements are commonplace in mortgage contracts. Lenders entered into the original agreement with the understanding that the financing could be terminated on change in ownership of the security property. This is an essential protection for the long-term portfolio lender against the vagaries of the economy far into the future.

Though proponents of mortgage assumptions frame their arguments "in the consumer's interest", there are anti-consumer aspects to preventing exercise of due-on-sale clauses. For example:

(1) Mortgage lenders must somehow recover the portfolio losses they experience when due-on-sale enforcement is denied them. The most obvious means of accomplishing this is to post higher interest rates on all new mortgages. The result is that new borrowers -- most often first-time home buyers -- in effect are required to subsidize those individuals fortunate enough to possess the large capital amounts necessary to qualify for the assumption of existing mortgages -- individuals who, in many cases, attained that capital through the sale of another

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home. The Committee must determine whether the higher interest rates resulting from this subsidy to a privileged group is in the best interest of the larger consumer class of potential home buyers.

(2) Assumptions of low-interest loans enable sellers to demand higher prices for their properties, thereby contributing to housing-cost inflation. In an October 19, 1981, article in the Washington Post, one local realtor was quoted as saying, "People are going where they can get good financing. Shrewd sellers realize that they are selling more than real estate, but also a low-interest, long-term mortgage so they can ask a higher price."

(3) Housing speculators are major beneficiaries of assumption of low-yielding mortgages. Again, the same October 19, Washington Post article quotes two different realtors as admitting to such speculation.

This Committee is well aware of the declining net worth position of most thrift institutions. That net worth is being rapidly eroded as a result of the squeeze between market-rate deposits (in increasing proportion) and the legacy of fixed-rate, 30-year mortgage loans (made in the expectation that our Government could control inflation and provide economic stability). State-imposed restrictions on due-on-sale condemn our institutions to a "life sentence" of unprofitable operation as long as liability costs persist at double-digit levels. Obviously, this affects the likelihood for eventual assistance from the FSLIC.

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Both S. 1703, recommended by FHLBB Chairman Richard Pratt, and your S. 1720, Mr. Chairman, address the due-on-sale problem.

Title III of S. 1703 would preempt State governments from denying the enforcement of due-on-sale clauses in the case of Federal institutions -- national banks, Federally-chartered S&Ls only. The laws governing state-chartered depositories would not be so preempted. The mortgage market is national in scope and the financial health of thrift institutions is vital to the stability of our entire financial system. We see no justification for restricting override of due-on-sale to Federally-chartered depositories. Part C of Title I of S. 1720 would apply to all mortgage lenders, regardless of charter. The section also would permit States to override the preemption within three years of enactment of S. 1720.

The U. S. League of Savings Associations supports extension of the preemption to all mortgage lenders, State- as well as Federally-chartered, as provided in S. 1720.

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Extraordinary Authority Relating to Thrifts

Though conditions are difficult today for savings and loan associations, we do not object to most of the extraordinary supervisory authority requested by the regulators -- as long as it is considered, as you have done, along with broader powers and Federal preemption needed to deal with the underlying borrow-short, lend-long dilemma which so disadvantages thrift institutions.

There is one provision, in particular, which we continue to oppose. That is the prospect of inviting commercial bank and bank holding company takeovers of distressed thrift institutions.

As you know, we supported the efforts of the leadership of this Committee in the 96th Congress (Senate amendments to H.R. 5625) to attain legislation prohibiting thrift acquisitions by bank holding company firms generally. We continue to find persuasive Senator Proxmire's justification for the ban as presented on the Senate floor:

"The purpose of the amendment is to make sure that the period of transition ... that the S&L and mutual savings bank industry is entering in the wake of the ... Deregulation Act ... does not lead to a wave of takeovers of S&Ls and mutual savings banks by banks ... Congress has ... changed the rules of the game for thrift institutions, presenting them with a considerable challenge that they must meet in order to continue in business and continue to satisfy our nation's housing credit needs. At the same time, the new powers given thrifts have made these institutions more attractive acquisition targets ... and have made .. (such) acquisitions a more potent method of circumventing restrictions on interstate branching by commercial banks."

It is our understanding that the Federal Reserve Board, in the course of submitting a study to the Committee on the

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implications of the acquisition of thrifts by bank holding companies, has again requested the guidance of Congress on this important policy issue. And, we understand that at least one application is pending for a bank takeover of a thrift; given the changes in thrift powers of the past few years, application of the existing "closely related to banking as to be a proper incident thereto" standard might well lead to approval in the absence of Congressional guidance.

With this prospect in mind, we again recommend Congressional direction through a prohibition generally of bank holding company acquisitions of thrifts.

Our recommendation applies in supervisory situations, as well. Certainly the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation have demonstrated in recent weeks their ability to deal with problem situations within the framework of FSLIC-insured partnerships. In the present economic environment (and considering bank earnings, Table 1), inviting bank holding company bids in the auction for troubled thrifts would result overwhelmingly in bank takeovers. In effect, market-entry opportunities would be auctioned off to the lowest bidder. In some markets this would concentrate banking resources; to the degree thrifts are swallowed whole, the availability of housing credit would suffer. As Senator Proxmire correctly observed, this is a back-door route around the McFadden and Douglas Acts -- which you have put off for consideration at a later date. Furthermore, opening the door to bank acquisition of thrifts as a supervisory matter may not

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be a lasting solution; after the expansionary appetites of a few big banks are satisfied, the FSLIC and FDIC may still find themselves in a desperate search for partners.

Turning to other emergency assistance portions of S. 1720 and of S. 1703, we have no way of knowing the situation confronting the Federal Deposit Insurance Corporation -- and therefore do not express an opinion on the sections affecting their supervisory powers.

We would also like to comment briefly about additional sections -- and about a section contained in earlier drafts -- but deleted in this version.

The omission is the section of Chairman Volcker's draft of May 18 providing an increase in the FSLIC's credit line to the Treasury from the current \$750 million (established in 1950) to \$3 billion. As indicated, this backstop authority has not been revised in over 30 years -- though the savings and loan business has grown from \$13 billion in insured deposits to almost \$500 billion. We understand that the Treasury objects to the increased backstop authority. We believe, however, that the increase in the Treasury borrowing line for the FSLIC is simply a prudent Governmental housekeeping measure and may have some reassurance value to depositors in insured institutions.

Similarly, portions of earlier drafts providing the FSLIC with authority to "make deposits in" and "purchase securities of" institutions in need of assistance should be restored.

The U. S. League has long advocated the Federal Home Loan Bank Act amendments provided by Section 156 of S. 1720 (Section

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406 of S. 1705). The statutory requirement that District FHLBanks tie up 20 percent of their earnings semi-annually by adding them to reserves is a relic from the '30s; it prevents the District Banks from fulfilling their purpose as central liquidity facilities to serve the temporary borrowing needs of member savings and loan associations and mutual savings banks. Similarly, the District Banks should be permitted, when severe financial conditions exist, to distribute accumulated undivided profits as dividends.

Section 157 of S. 1720, enabling the FSLIC to borrow from its companion Federal Home Loan Bank System, is also a useful change in existing law. The Federal Home Loan Bank Board, as "parent" of both entities, should have greater flexibility in adjusting the resources at its command to meet economic conditions affecting savings and loan institutions.

While we do not oppose the first purpose of Section 158 -- authority for the FSLIC to suspend temporarily pay-out from its old Secondary Reserve when extraordinary financial conditions exist for the Corporation -- we have reservations about the remaining language: "and utilize said reserve on the same basis as the Primary Reserve." This latter authority raises problems of equity in the treatment of institutions which, for a variety of reasons, "over paid" into the Secondary Reserve years ago, and presents accounting and financial statement disclosure difficulties, too.

The language in Section 153 of S. 1720 (Section 403 of S. 1703), regarding emergency stock charters, contains an important

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refinement in existing law; indemnification agreements would be negotiated on a case-by-case basis between the FSLIC and FDIC when a mutual savings bank which has converted to federal charter (and switched insurance-of-accounts funds) subsequently becomes a supervisory problem.

One final comment about the emergency assistance requests of the regulators. The Committee may wish to consider, as your House counterparts have done, a one-year "sunset" on the authorities granted -- particularly in light of your intention to examine the broader questions of McFadden and Douglas Act amendments next year.

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Increased Account Insurance for IRA/Keogh Depositors

One very important addition to the Administration-approved "Pratt Bill" made by you, Mr. Chairman, is increased insurance-of-accounts coverage for IRA/Keogh depositors.

The present \$100,000 limit is clearly insufficient for retirement savings. Frequently, customers open these accounts with sizeable lump sum distributions from pension plans, either on early retirement, or when plans are terminated by employers. Furthermore, by their very nature, IRA/Keogh accounts involve systematic annual additions -- in amounts recently expanded (doubled in the case of self-employed) by the Tax Reduction Act. And, as you are well aware, the Tax Act contains an authorization (beginning January 1) for a universal IRA which permits participants in qualified company pension plans to supplement their retirement planning with IRA savings programs.

IRA/Keogh depositors are valuable long-term customers, particularly for mortgage lenders such as savings and loan associations -- since the tax laws inhibit withdrawals. Forcing them to split accounts or depositories when their account surpasses \$100,000 is a needless inconvenience.

We strongly endorse the increase in deposit insurance coverage for these retirement savings plans.

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Miscellaneous

We would like to comment briefly about a number of miscellaneous sections of S. 1720 and S. 1703.

We strongly support the modification in existing law improving the ability of the Federal Home Loan Mortgage Corporation to purchase loans more than one year old. The recently developed FHLMC "swap program" is an important new tool in our quest to turn our low-yielding loans in portfolio into potentially liquid assets. The existing statutory language restricts the flexibility needed to meet the demand for this program.

One way to help ensure that the nation's thrift institutions, as well as other types of lenders, will continue to provide support to the housing market in the future, is to expand the secondary market for home mortgages. In the future, lenders will want to sell more of the fixed rate mortgages they originate, as well as many of the adjustable rate mortgages they make. In our view, the current secondary market is not large enough to absorb the increased demands which will be placed upon it.

The Federal Home Loan Mortgage Corporation has proposed a plan by which its operations could be expanded by \$30 billion per year to help accommodate the increased demand for secondary market assistance. The U.S. League supports this legislation and urges the Committee to give careful consideration to it as soon as possible.

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Sections in both bills (174 through 178 of S. 1720, 504 through 508 of S. 1703) which modernize the collateralization-for-advances language of the 1932 Federal Home Loan Bank Act, provide short-term dual FSLIC coverage for common depositors of merged institutions, delete obsolete FHLBank stockholding requirements for a handful of member institutions, permit compensation for Federal Savings and Loan Advisory Council members, and restrain in-and-out membership in the Federal Home Loan Bank System are all desirable.

By separate letter to Senator Tower dated July 21, 1981 (at the time of hearings on S. 1406), we have previously endorsed Title IV of S. 1720 providing a Federal override of state usury limits on consumer credit.

We note that Section 230 of S. 1720 deals with amendments to Title II of the Director Interlocks Act. We believe that title is in need of change because its effect is one of discouraging mergers -- a particularly unwelcome result in the current climate.

But, we view with skepticism provisions such as those in Section 230 which tighten rather than relieve restrictions involving interlocking directorates. We would recommend that Section 230 be dropped from the bill and that the Committee also consider modifying Title II so that it does not mandate a choice between maintaining existing directors or effecting a merger. In particular, the legislation needs to be clarified to assure that directors "grandfathered" for 10 years at time of enactment in 1978 are not "cut off" by virtue of a "change in circumstances" such as a merger or branch expansion.

We also support the direction of Section 211 of S. 1720 -- the small institutions' exemption from the "universal" reserve requirements imposed by the Monetary Control Act. Frankly, given the NOW accounts performance to date at savings and loan associations, this exemption level could be raised significantly without impacting the conduct of monetary policy. (In the aggregate, all S&Ls of \$100 million or less in size hold less than \$2 billion in NOW balances.) A threshold of \$25 million would be reasonable, in our view. Further, the current statute could be refined to permit quarterly reporting by smaller institutions. We know of one case where rural institutions are paying \$1,200 a year for service bureau monthly reporting of Monetary Control Act data, even though there is no prospect that transaction balances will grow to reservable liability size.

Finally, we do not oppose the authority provided in S. 1720 for national banks to deal in and underwrite revenue bonds. If this authority should be construed to include mortgage subsidy bonds -- an area of considerable activity in recent years -- we would see no reason to exclude savings and loan participation, however.

S. 1721 -- Consolidating Insurance-of-Accounts Agencies

We oppose your companion piece of legislation, Mr. Chairman, which would merge the FSLIC and share insurance funds into the FDIC (S. 1721).

Expanding the FDIC to include savings and loan associations insured by the FSLIC and credit unions insured by NCUA would create an inefficient regulatory organization. At the present time, for example, the FHLBB finds it necessary to deal with a number of problem institutions. This process moves much more expeditiously when the Federal Savings and Loan Insurance Corporation is a constituent part of the Federal Home Loan Bank Board's operations. Requiring the FHLBB to operate with an entirely different agency, the FDIC, would make for many inefficiencies relative to the present system. We imagine, the same observation would pertain to the NCUA.

The situation would be particularly difficult in the case of State-chartered, but Federally-insured savings and loan associations. Divorcing the FSLIC from the Home Loan Bank Board would, in effect, add a third layer of supervision -- the State supervisor, the FHLBB and the FDIC. Thus an additional layer of supervision would result from the proposed legislation for approximately 2800 institutions.

Beyond these problems it should be noted that the competition which serves as a self-regulator in the private sector can also serve this function to some degree with respect to governmental agencies performing similar roles. It would be a mistake to create a single monopolistic agency rather than to continue with three quasi-competitive organizations.

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Our objections to consolidating FSLIC with FDIC (as well as with the National Credit Union Insurance Fund) have been set forth. Whatever policy reasons may seem to justify this consolidation, it should not be used to gain "back door controls" over S&L associations by the FDIC. For example, Section 131 of the bill (S. 1721) would, among other things, subject S&L associations to the 1966 Bank Merger Act. This law pertains to large commercial banks seeking merger partners and wanting some degree of certainty that the merger -- after some reasonable period of time -- will not be challenged by government agencies on anti-trust grounds. In general, the policy of the Bank Merger Act need not be applied to the merger of S&L associations principally because the Justice Department has rarely, if ever, sought to block such mergers for anti-competitive or anti-trust reasons. Secondly, the FHLBB, through informal procedures, already checks with the Justice Department to determine if there is any anti-trust objection.

In summary, the principal reasons for consolidating the insurance corporations are presumably to strengthen the account insurance functions and to reduce the number of agencies in the name of increased government efficiency. Combining the insurance corporation should not be used to expand FDIC control over S&L associations in areas outside the account insurance function.

S. 1686, the Local Government NOW Account Bill

We are pleased to support Senator Lugar's S. 1686, the Local Government NOW Account Bill. More efficient cash management should be a goal at all levels of government, and savings and loan associations are anxious to offer their services in achieving that objective. Several years ago the Advisory Commission on Intergovernmental Relations detailed in a report to your Committee how state laws and archaic collateralization requirements operate to exclude savings associations from receiving government deposits. Higher public funds' FSLIC and FDIC coverage adopted at that time helped to unlock some of those funds for investment in savings associations. Reform of the Federal tax and loan account system also provided some new opportunities for housing-specialized depositories.

S. 1686 would continue that progress. Savings and loan associations would be permitted, along with commercial banks and credit unions, to accept short-term surplus governmental deposits and pay a rate comparable to the return for Federal tax-and-loan funds. Furthermore, the legislation would correct a situation where only a very limited number of governmental units -- thanks to a recent court decision -- are able to avail themselves of NOW accounts. Both actions would improve the management of the public's monies at the State and local level -- to the benefit of taxpayers, governmental officials and institutions alike.

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We might also renew our request at this point, Mr. Chairman, as we have done repeatedly in the past, for full, 100% FSLIC/FDIC insurance of public funds. Your Committee unanimously approved such legislation in the last Congress. The FSLIC has testified that such broadened coverage for public unit accounts has a negligible impact on the exposure to loss of the Insurance Fund.

Warehousing Mortgages, Money Market Mutual Funds

Before concluding, we would like to again urge Committee action on two matters within your jurisdiction -- but not contained in the comprehensive legislation pending today.

While such provisions as the due-on-sale preemption, amendment to the FHLMC statutory restriction on purchasing older loans, and the "joint venture" authority for Federally-chartered savings and loans all address parts of the low-yielding mortgage portfolio problem ... the magnitude of this drag on S&L operations is immense. Over \$300 billion in loans remain at unproductive yields in institutional portfolios.

An additional tool for dealing with this fundamental problem is S. 985, legislation introduced by Senator Moynihan, which would permit the exchange of low-yielding mortgages for non-marketable subordinated notes from the FSLIC and FDIC. The plan would utilize the accumulated resources of the FSLIC and FDIC funds within carefully-defined limits: it does not involve appropriated funds. Institutions permitted the "swaps" would be required to redeem the warehoused loans from the third to tenth year after the exchanges.

We continue to believe that the efficient conduct of our nation's monetary policy requires some accountability for the enormous money market mutual fund industry ... now, \$160 billion in assets. Subsequent to your hearings in May on this subject, Chairman Volcker testified on the House side that reserves' authority for those money funds with transactionable features would be desirable for the conduct of monetary policy.

As of September 9, 1981, MMMFs of all types had less than 14% of their assets in U.S. Treasury and Federal agency securities; 35.8% was invested in commercial paper; 22.5% in large CDs (almost exclusively of the largest, money center banks); and, 13.9% in Eurodollar and Yankeedollar CDs. The phenomenal growth of the commercial paper markets, beyond the reach of the Fed's controls on bank lending to corporate borrowers, has been made possible by the MMMFs. The jumbo CD investment reflects the drain of savings from local communities to large, money center banks. The significant use of foreign depositories and foreign markets points up the ability of MMMFs to complicate the operation of domestic monetary policy.

We would hope that your comprehensive legislative effort would not ignore the money market fund problem. Placing reserves on funds with transaction account accessibility is one step. Another might be to require that funds devoted to serving individual investors invest significantly in U.S. Treasury and agency securities. This "shift to quality" would not make MMMFs uncompetitive. At the same time, it would increase the demand for Treasury issues, with the important side effect of lowering the costs of financing the deficit and depressing the private sector deposits tied to Treasury rate movements.

* * *

This concludes our testimony.

Mr. Chairman, again we compliment you for attempting to deal with the situation confronting savings and loans and other financial institutions in a comprehensive manner. Your principal introduction, S. 1720, is a far-reaching and complex effort. Because of the brief time between announcement of these hearings and the preparation of this statement it was impossible for our counsel to examine in detail all of the statutory language used to accomplish various objectives. We would like to reserve an opportunity to submit further technical suggestions by the conclusion of your hearing record, if that would be acceptable.

Again, you have our appreciation for being permitted an opportunity to appear today.

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ADDENDUM A

Excerpts From The Transcript
Of The Meeting
Depository Institutions Deregulation Committee
September 22, 1981

(Following motion by DIDC Chairman and Treasury Secretary Regan
to increase passbook savings rates November 1, 1981)

MR. VOLCKER:

"I come out with a different conclusion. In this case I do think our injunction to have due regard for the safety and soundness of the depository institutions is relevant and important. In this case all the analyses that I have suggest that there would be a very substantial earnings' cost to the thrift institutions and to the commercial banks for that matter ...

"...I have to give some weight to the fact that all the effected institutions are rather unanimous in coming to the conclusion that it is going to cost them a lot of money and not be that much a marketing help. ... (E)ven the rate you're talking about is still not competitive and the interest-sensitive customer is going to move elsewhere. (T)he earnings pressure on the industry seems to me to militate against changing the rate at this time. ...

"The impact on earnings in this case seems so severe in a situation in which the safety and soundness of these institutions would be jeopardized that I am forced to arrive at the conclusion that we ought to keep this on the agenda continuously, but not act today.

MR. PRATT:

"Well, I would certainly agree with Chairman Volcker's comments. A point that may be of interest is that each one percent change (in passbook rates) we think will impac thrift earnings by about billion per year ... just for savings and loan associations. We see no factors which would offset that and given the situation of the industry today, I think that it would be a dangerous experiment.

"Another comment that may be of some importance is that our estimate in passbook accounts is that 40 percent of the money is in accounts of \$10,000 or above. Now, I don't know why it's there, and what the motivations of people putting money in passbooks are, but it isn't entirely limited to small savers.

(Later)

MR. VOLCKER:

"...What's also clear is that we have a very large earnings problem in the thrift industry. Our calculations suggest that an increase of the sort that you are proposing would cost the thrifts about as much as the All Savers Certificate gains them. We would not be going forward in that respect. Here we have a piece of tax legislation that from many points of view isn't very desirable. Its one justification was to help thrift earnings as understand it, and it seems to me a little curious and dangerous if we took an action here to, in effect, wipe out that effect.

MR. PRATT:

(Following Secretary Regan's reply).

"I think, Mr. Chairman, that you have eloquently pointed out that doing this (150 basis point passbook increase) would only remove a half to a third of the effect of All Savers. I don't find much comfort in that, I must say.

ADDENDUM B

What The Courts Have Said About The DIDC

"The Court finds the defendants' (DIDC) arguments in support of the regulations (adopted June 25, 1981 establishing a phase-out schedule for savings rate ceilings beginning with four-year accounts) unpersuasive. Accepting that language of Public Law 94-200 must be integrated with that of Public Law 96-221 in some fashion defendants argue that congressional approval is only required for removal of all interest limitations in effect on December 10, 1975, but that Congressional approval is no longer required when limitations are removed as to particular categories of accounts. This meaning is simply not to be found in Section 204 of Public Law 96-221, to which defendants point, or in any other provision of the statutes or the legislative history."

Gesell, J., U.S. League of Savings v. Depository Institutions Deregulation Committee, Civ. Action 81-1666, U.S.D.C. (D.C.), July 31, 1981.

* * * *

"A reading of the administrative record before the Court fails to reveal the basis upon which DIDC found good cause existed to dispense with Administrative Procedure Act procedures. ...

"The DIDC met on May 6, 1980, at which time it was proposed that DIDC staff undertake a study to review the implications of a reemergence of the interest rate differential on MMC's. It is clear from the minutes of that meeting that DIDC contemplated the necessity of taking action in the near future. Action was taken on May 28, 1980. Yet, had the DIDC issued notice to the public concerning contemplated action at the time of the May 6th meeting (or shortly thereafter), DIDC would have had the benefit of public comment by May 28, 1980 the time at which it adopted the regulations. Surely it cannot be argued that the public was not interested in these matters and would not have responded promptly to the opportunity to comment. Nor can the Court accept defendants' assertion that advance notice could lead to disruption within the financial community. The anticipated reemergence of the interest rate differential was not a closely guarded secret. It is safe to assume the financial community was well aware of this possibility. The Court cannot perceive of any harm that would have occurred if the public were invited to comment on the implications of the reemergence, just as DIDC staff members were directed to do. ..."

Johnson, J., U.S. League of Savings v. Depository Institutions Deregulation Committee, et. al., Civ. Action 80-1486, U.S.D.C. (D.C.), June 30, 1981.

"It is clear the meeting at which new regulations were considered took place before the Order was issued. However, it is equally clear that DIDC was aware of the Court's Order at the time it published the new regulations in the Federal Register. The more prudent approach for the DIDC to follow would have been to reconvene to consider the new regulations in light of the Court's directive. Because the regulations adopted on June 25, 1981 are not before the Court in the present action the Court cannot order DIDC to delay the effective date thereof. The Court can and will order defendants to reconsider the May 28, 1980 regulations, which are the subject matter of the action, forthwith."

Johnson, J., ibid., reconsideration and amendment of judgement, July 24, 1981.

TABLE I - COMMERCIAL BANKS EARNINGS, EARLY REPORTS

Name	12/31/80 Million Assets	3rd Qtr.		9 Months	
		Millions Net Income	% Change	Millions Net Income	% Change
Chemical, NY	\$ 40,969				
1981		\$47.8	+ 10.1%	\$157.0	+ 28.3%
1980		43.4		122.4	
1st United Bankcorp.	\$ 2,018				
1981		6.8	+ 33.3%	17.9	+ 32.6%
1980		5.1		13.5	
Marine Midland	\$ 17,420				
1981		20.6	+ 66.1%	58.5	+ 47.0%
1980		12.4		39.8	
Pittsburgh Natl. Corp.	\$ 6,225				
1981		14.6	+ 19.7%	41.9	+ 10.3%
1980		12.2		38.0	
Citizens & Southern	\$ 4,341				
1981		12.0	+ 39.5%	33.1	+ 20.4%
1980		8.6		27.5	
First & Merchants	\$ 2,301				
1981		6.1	+ 60.5%	13.6	+ 16.2%
1980		3.8		11.7	
First Union Corp.	\$ 4,271				
1981		7.4	+ 29.8%	20.9	+ 2.0%
1980		5.7		20.5	
Girard Co.	\$ 4,386				
1981		9.7	+ 11.5%	28.0	+ 12.9%
1980		8.7		24.8	
Wachovia Corp.	\$ 5,654				
1981		11.4	- 5.8%	39.7	+ 12.1%
1980		12.1		35.4	
New Eng. Merchants	\$ 2,549				
1981		7.3	+ 73.8%	26.5	+ 28.0%
1980		4.2		20.7	
Southeast Banking	\$ 5,854				
1981		12.2	--	36.8	+ 3.1%
1980		12.2		35.7	
1st Natl. Cincinnati	\$ 1,489				
1981		5.9	+ 13.5%	19.2	+ 17.1%
1980		5.2		16.4	
NDB Bankcorp.	\$ 10,869				
1981		18.2	+ 19.7%	46.6	- 8.4%
1980		15.2		50.9	

SOURCE: Wall Street Journal, New York Times, October 6-10.

The CHAIRMAN. Mr. Coles?

Mr. COLES. Mr. Chairman, members of the committee, I am Jim Coles, president of United Savings of Texas and treasurer of the National Savings and Loan League, on whose behalf I appear before you today.

The National League met last week at its 38th annual convention. As you would expect, the issues before the committee today were of primary concern to all of us. Before commenting on the legislation, I want to report to this committee that our meeting was both upbeat and optimistic. Our members are determined not only to survive the present environment, but to come out of it stronger and more profitable.

To a great extent, our optimism hinges on the expectation of passage of the legislation before this committee. As we said to the committee last spring, the savings and loan industry is facing a hostile economic and financial environment that has caused a severe earnings problem. The source of this problem continues to be the high and volatile interest rates our economy has experienced since the mid-1970's, but especially during the last 18 to 24 months.

In the long run, we cannot function in that kind of environment, at least not as we are presently structured. We are still operating in a world where we are victims of our former very restricted assets structure, but at the same time we have to cope with a liability structure which has changed drastically in the last 2 years. In that period of time, savings and loan profitability has dropped from a 0.83-percent return on assets in 1978 to a negative 0.49-percent return during the first half of 1981. This is due almost entirely to increasing market sensitivity and rising costs of our liabilities.

Commercial banks, by contrast, have for the most part remained quite profitable, not because their liabilities are so different, but because their assets composition is much more market-sensitive than ours.

I think it bears repeating that thrift institutions are experiencing financial hardship today because we have done our job well. Beginning in 1933, the Congress called upon us to provide long-term financing for homeownership. We did that. Beginning just a few years ago, the Congress also called upon us to pay market rates of interest to our depositors. We are currently doing that. The net result is assets with fixed return and average lives of approximately 10 years, and a liability mix of 75 percent having maturities of less than 1 year and costs fluctuating wildly from month to month.

IMMEDIATE ASSET DEREGULATION

Given the pace of liability deregulation and the growing direct competition from unregulated financial conglomerates, who are free to operate nationwide, there is, in our opinion, only one course left to us—immediate asset deregulation.

Both S. 1703 and S. 1720 essentially represent the principle of specialization by choice. With this authority, thrift institutions would be able to meet the credit demands and use the profit opportunities of their individual markets. There would in all likelihood still be specialization, but it would vary in type and degree,

from place to place, and from institution to institution. We believe that most thrift institutions would remain closely associated with the real estate industry, given their existing management skills and expertise.

It is with this background and this view of the future that we have endorsed S. 1703 and the comparable sections of S. 1720. We do, however, have a few suggestions for changes, and additions, which we hope this committee will incorporate in the legislative package to be sent to the Senate floor.

Title I of S. 1703 and title I, part A of S. 1720 would authorize direct financial assistance to financially distressed institutions. It would permit the regulatory agencies to arrange mergers across State lines, and among different types of institutions. The National League supports the powers that have been requested by the regulatory agencies; however, we do have some concern that we believe can be accommodated in the context of the legislation they have proposed.

In order to minimize the possible threat to the dual banking system, we recommend that Congress admonish the regulators to seek mergers of like charters and to consult with State regulators where State-chartered institutions are involved.

We also feel very strongly that Congress should insure that mergers between different types of institutions are only a last resort, and that savings and loan holding companies have reciprocal power to acquire banks. Emergency acquisitions of State-chartered S. & L.'s in another State by multiple S. & L. holding companies have the advantage of permitting the retention of the State charters of acquired institutions. We believe the preservation of the State charters in emergency cases should be given this high priority by the FSLIC in order to avoid erosion of the dual banking system. We also recommend that the committee approve interstate acquisitions of S. & L.'s by multiple S. & L. holding companies in nonemergency cases. The interstate prohibition on such acquisitions is outmoded, given today's economic climate.

We further recommend that section 40(C)(2) of the National Housing Act be amended so that multiple S. & L. holding companies would be treated the same as the unitary holding companies with respect to permissible nonsavings-and-loan activities.

In addition, the National Savings and Loan League supports authority to permit S. & L.'s to enter into voluntary mergers and to branch across State lines.

The National League supports Federal preemption of State restrictions on due-on-sale. Without the clear right to exercise the due-on-sale provisions of a mortgage contract, the current financial strain on thrift institutions will continue, despite the passage of this legislation, and the very positive steps taken this year by the Federal Home Loan Bank Board in authorizing flexible mortgage instruments for all institutions.

The longer the old, below-market loans remain on the books, the slower the recovery of our institutions. I think everybody understands that it will take some time for our associations to realize the full benefit of the powers granted by this legislation. The longer these old loans remain on the books, the longer it will take for these benefits to be truly effective.

Restrictions on the use of due-on-sale provisions directly and adversely impact the financial health of the mortgage lending institutions. Because this adverse effect would apply to both Federal and State-chartered institutions, we believe that Federal preemption is fully justified for all lenders without the authority of the States to reimpose restrictions. The availability of mortgage credit throughout the Nation will increasingly depend on investments through secondary market mechanisms, specifically FNMA and FHLMC. We strongly believe that a complete and permanent preemption is essential for the efficient operation of this important component of our mortgage delivery system.

As I mentioned earlier, we believe most thrift institutions will remain closely tied to real estate. Many State-chartered savings associations presently have authority to invest directly in real estate developments. This investment opportunity has been a very important and useful profit opportunity for these institutions. The National League urges this committee to include in its legislation the same authority for federally chartered associations.

We believe that the inclusion of such authority would be consistent with the deregulation theme of the legislation, and would at the same time provide a positive incentive for Federal associations to remain essentially real estate specialists.

AGENCY CONSOLIDATION

The National League must oppose S. 1721 at this time, Mr. Chairman. We can find no public benefit to this proposal. Furthermore, the prospect of federally chartered thrifts being regulated by both the FDIC and the Federal Home Loan Bank Board runs counter to the principle of deregulation. While S. 1703 and S. 1720 hold out the prospect of diminishing the degree of specialization of depository institutions, this will not happen simply because one of these bills becomes public law. No one today can predict the pace or ultimate extent of so-called homogenization. For this reason, Mr. Chairman, we respectfully suggest that S. 1721 is an idea whose time has yet to come.

We would also ask the committee to consider the point that having the insurance, supervision, and liquidity function under one roof [the FHLBB] for thrifts is a superior model to the fragmented Fed-FDIC-comptroller management for banks. In our opinion the existing regulatory structure for thrifts is the more efficient of the two.

Section 701 of S. 1720 would raise the insurance of accounts limits to \$250,000 for retirement savings accounts. The National League strongly supports this provision, but would urge the committee to make this increase applicable to all insurable accounts. This action would, in our opinion, have a very beneficial effect on public confidence in our regulated depository institutions and contribute in a positive way to our efforts to attract savings.

In summary, Mr. Chairman, the National League urges this committee and the Congress to review the restructuring issues with a sense of urgency. The financial marketplace is changing at a very rapid pace, with virtually unregulated entities offering services heretofore reserved to the regulated depository institutions. The

deregulation of competition for deposit liabilities is virtually complete.

Yet, as of today, the ability of traditional depository institutions to offer financial services demanded by the marketplace is still restrained by old statutes and regulations.

Since it is highly unlikely that this Congress will or can return us to a tightly regulated financial market, the only viable course of action is to remove the asset constraints so we can at last and at least have a chance to meet the competition in the years ahead.

Thank you, Mr. Chairman.

[The complete statement follows:]

Testimony of
James A. Coles
National Savings and Loan League
before the
Committee on Banking, Housing and
Urban Affairs
United States Senate
on S 1686, S 1703, S 1720, and S 1721
October 21, 1981

Mr. Chairman, members of the Committee, I am James A. Coles, President of United Savings Association of Texas, and treasurer of the National Savings and Loan League on whose behalf I appear before you today. The National League welcomes this opportunity and appreciates your leadership in introducing S 1703 and S 1720, and in promptly calling these hearings.

The National League met last week at its 38th Annual Convention. As you would expect, the issues before this Committee were of primary concern to all of us. Before commenting on the legislation, I want to report to this Committee that our meeting was upbeat and our members optimistic. They are determined not only to survive the present economic climate, but to come out of it stronger and more profitable than before. To a great extent, that optimism hinges on the expectation of passage of the legislation before this Committee.

The Savings and Loan Industry Environment

As we said to this Committee last spring, the savings and loan industry is facing a hostile economic and financial environment that has caused a severe earnings problem. The

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source of this problem continues to be the high and volatile interest rates our economy has experienced since the mid-1970s, but especially in the last 18 to 24 months. In the long run, we cannot function in that kind of environment, at least not as we are presently structured. We are still operating in a world where we are victims of our former, very restricted asset structure but at the same time, we have to cope with a liability structure which has changed drastically in the last two years. In that time, savings and loan profitability has dropped from 0.83% return on assets in 1978 to -0.49% in the first half of 1981. This is due almost entirely to the increasing market sensitivity and rising costs of our liabilities. Commercial banks, by contrast, have for the most part remained quite profitable, not because their liabilities are so different, but because their assets composition is much more market sensitive than ours.

As I indicated, Mr. Chairman, inflation is the primary reason we are experiencing our current earnings problems. But, if we had the kind of rate-sensitive assets we have been asking for during the last ten years, we would be in a much better position to cope with volatile interest rates. Much of that disadvantage, at least prospectively, was taken care of through passage of the Deregulation Act and the Bank Board's recent action on adjustable mortgage loans, an action we very much support. However, as I indicated earlier, it will take a considerable period of time for those new powers to be

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reflected in the asset composition and earnings of our associations.

I think it bears repeating that thrift institutions are experiencing financial hardship today because we have done our job well. Beginning in 1933, the Congress called upon us to provide long-term financing for home ownership. We did that. Beginning just a few years ago, the Congress called upon us to pay market rates of interest to our depositors. We are doing that. The net result: assets with fixed return and average turnover of approximately ten years and a liability mix with 75% having maturities of one year or less and costs fluctuating wildly from month to month.

Given the pace of liability deregulation and the growing direct competition from unregulated financial conglomerates who are free to operate nationwide, there is, in our opinion, only one course left to us: immediate asset deregulation. If we are to have any hope of competing for deposits and remaining financially viable, we must more closely match the maturities and the interest rate sensitivity of assets and liabilities.

Both S 1703 and S 1720 essentially offer the asset flexibility thrifts will need in the years ahead. Title II of S 1703 and Title I, Part B, of S 1720 represent the principle of specialization by choice. With this authority, thrift institutions would be able to meet the credit demands and use the profit opportunities of their markets. There would,

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in all likelihood, still be specialization, but it would vary in type and degree from place to place and institution to institution. We believe that most thrift institutions would remain closely associated with the real estate industry given their existing management skills and expertise. The essential point is, given the dynamics of the market and the uncertainty of the future, it makes no sense to statutorily mandate specialization. If we are to survive, we must each be able to respond to our own markets and do what we do best and can do profitably.

It was with this background and this view of the future, that we have endorsed S 1703 and the comparable sections of S 1720. We do, however, have a few suggestions for changes and additions which we hope this committee will incorporate in the legislative package to be sent to the Senate floor.

Emergency Powers of Regulatory Agencies

Title I of S 1703 and Title I, Part A, of S 1720 would authorize direct financial assistance to financially distressed institutions, and would permit the regulatory agencies to arrange mergers across state lines and among different types of institutions. The National League supports the powers that have been requested by the regulatory agencies, however, we do have some concerns that we believe can be accommodated in the context of the legislation they have proposed. In order to minimize the possible threat to the dual banking system, we recommend that Congress admonish the regulators to seek mergers

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of like charters and to consult with state regulators where state-chartered institutions are involved. The federal regulators should be encouraged to use S&L holding companies with state-chartered S&L subsidiaries as an alternative merger vehicle to converting an S&L to a federal charter for that purpose. We also feel very strongly that Congress should ensure that mergers between different types of institutions are only a last resort, and that savings and loan holding companies have reciprocal power to acquire banks.

Emergency acquisitions of state-chartered S&Ls in another state by multiple S&L holding companies have the advantage of permitting the retention of the state charters of acquired associations. We believe that the preservation of the state charters in emergency cases should be given this high priority by the FSLIC in order to avoid erosion of the dual chartering system.

Section 401(a) of S 1703 adds a new subsection (m) to section 408 of the National Housing Act, (section 408 is the "Savings and Loan Holding Company Act") which authorizes the FSLIC to merge insured institutions eligible for assistance pursuant to section 406(f) with, or transfer their assets to, other S&Ls or banks either intra- or interstate in accordance with a series of priorities stated in the new subsection. The new subsection would also permit "any company" to acquire control of such institutions or to acquire their assets.

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We interpret the words "any company" to include a multiple savings and loan holding company. We believe that the proposed new subsection (m) should be amended to make specific reference to multiple savings and loan holding companies, and to further make it clear that such holding companies may acquire eligible S&Ls across state lines in emergency cases.

We also recommend that the Committee approve interstate acquisitions of S&Ls by multiple S&L holding companies in non-emergency cases. The interstate prohibition on such acquisitions is outmoded given today's economic climate. We further recommend that section 408(c)(2) of the National Housing Act be repealed so that multiple S&L holding companies would be treated the same as unitary holding companies with respect to permissible non-savings and loan activities.

In addition, the National Savings and Loan League supports authority to permit savings and loan associations to enter into voluntary mergers and to branch across state lines.

Due-on-Sale

The National League supports federal preemption of state restrictions on due-on-sale. Without the clear right to exercise the due-on-sale provision of a mortgage contract, the current financial strain on thrift institutions will continue despite the passage of this legislation and the very positive steps taken this year by the Federal Home Loan Bank Board in authorizing flexible mortgage instruments for our institutions. The longer the old, below market, loans

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remain on the books, the slower the recovery of our institutions. I think everyone understands that it will take some time for our associations to realize the full benefit of the powers gained by this legislation. The longer these old loans remain on the books, the longer it will take for these benefits to be fully effective.

Restrictions on the use of due-on-sale provisions directly and adversely impact the financial health of the mortgage lending institutions. Because this adverse effect would apply to both federal and state chartered institutions, we believe that federal preemption is fully justified for all lenders without the authority of states to reimpose restrictions. The availability of mortgage credit throughout the nation will increasingly depend on investments through secondary market mechanisms, specifically FNMA and FHLMC. We strongly believe that a complete and permanent preemption is essential for the efficient operation of this important component of our mortgage delivery system.

T.I.L. Amendment

Section 703 of S 1720 would narrow the definition of "creditor" under Truth In Lending to exclude "arrangers of credit." The practical effect of this provision, in so far as we can determine, is to exclude from T.I.L. disclosure requirements the so called "creative financing" arrangements put together by real estate brokers. If T.I.L. has any value to home buyers, then it should be available to home buyers.

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however financing is obtained.

The National League continues to support efforts to simplify and rationalize T.I.L. and other disclosure requirements and we applaud Chairman Garn's leadership in this area. In this instance, however, we suggest that a more productive approach is to reevaluate the treatment of mortgage credit (regardless of its source) under T.I.L.

Collective Agency Accounts

The National League supports section 302 of S 1720 which would permit banks and S&Ls to offer collective agency accounts as part of their trust services. The section, however, should be amended to permit S&L holding companies and their affiliates, as well as S&L subsidiaries, to offer such accounts in order to accord parallel treatment.

S&L Trust Powers -- Technical Amendment

When it authorized trust powers for S&Ls last year, Congress stated that federally chartered S&Ls could exercise the power to act as "trustee, executor, administrator, guardian, or in any other fiduciary capacity in which State banks, trust companies, or other competing corporations ... are permitted to act under the laws of the State in which the association is located...." (Section 403, Public Law 96-221, the "Depository Institutions Deregulations and Monetart Control Act of 1980")

While this language is clearly intended to place S&L trust powers on parity with those of commercial banks operating in

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the state in which the S&L is located, it did not extend to S&Ls the exemptions under the securities laws relating to collective trust funds which commercial banks presently enjoy.

Common trust funds provided by commercial banks are exempt from registration (with certain exemptions pertaining to "Keogh" and Individual Retirement Accounts) under the Securities and Exchange Act, and are excluded as "investment companies" under the Investment Company Act. Commercial banks are also, unlike S&Ls, excluded from the definition of "investment advisers" under the Investment Advisers Act.

These basic exemptions in the Securities Act were adopted in 1970 long before trust powers for S&Ls were contemplated by Congress. We see no reason for excluding S&Ls from the exemption now that Congress has granted these powers to our industry.

We urge the Committee to provide this parity and have drafted amendments to amend subsection 5(n)(1) of the Home Owners' Loan Act, the subsection conferring trust powers on Federal S&Ls, to make it clear that they enjoy the same exemptions as "banks." We would be glad to submit this amendment (or amendments to the individual Acts) to the Committee for its consideration and to provide additional details.

Direct Investment in Real Estate

As I indicated earlier, we believe that most thrift institutions will remain closely tied to real estate in their

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lending and investment strategy. Many state chartered savings associations presently have the authority to invest directly in real estate developments. This investment opportunity has been a very important and useful profit opportunity for these institutions. The National League urges this Committee to include in its legislation the same authority for federally chartered associations. We believe that the inclusion of such authority would be consistent with the deregulation theme of the legislation and would, at the same time, provide a positive incentive for federal associations to remain essentially real estate specialists.

S 1686

S 1686, introduced by Senator Lugar would make state and local governments eligible to use NOW accounts at depository institutions. The National League supports this legislation since it clarifies what we understood the intent of Congress to be. We see no public benefit to be served by denying to state and local governments the opportunity to earn interest on their transaction account balances.

S 1721 -- Agency Consolidation

The National League must oppose S 1721 at this time, Mr. Chairman. We can find no public benefit to this proposal. Furthermore, the prospect of federally chartered thrifts being regulated by both the FDIC and the FHLBB runs counter to the principle of deregulation. While S 1703 and S 1720 hold out the prospect of diminishing the degree of specialization of

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depository institutions, this will not happen simply because one of these bills becomes public law. No one can today predict the pace or ultimate extent of so called "homogenization." For this reason, Mr. Chairman, we respectfully suggest that S 1721 is an idea whose time has not yet come.

Insurance of IRA/Keogh Accounts

Section 701 of S 1720 would raise the insurance of accounts limit to \$250,000 for retirement savings accounts. The National League strongly supports this provision, but would urge the Committee to make the increase applicable to all insurable accounts. This action would, in our opinion, have a very beneficial effect on public confidence in our regulated depository institutions and contribute in a positive way to our efforts to attract savings.

FHLMC Purchase of Mortgages More Than One Year Old

Section 173 of S 1720 contains an amendment to the Federal Home Loan Mortgage Charter Act removing the present restrictions which limit the Mortgage Corporation's purchase of mortgages originated more than one year prior to the purchase date to 20% of its assets.

The National League strongly supports this proposal. The present limitation hampers the ability of the Mortgage Corporation to fully implement its new program in which it will exchange or "swap" its participation certificates for below-market rate loans from the portfolios of savings and loan

associations and other eligible mortgage lenders.

This program will provide savings and loan associations with an effective way to convert their mortgages into assets with a higher degree of liquidity and market acceptance. This increased liquidity coupled with the Federal Home Loan Bank Board's recent approval of more realistic regulatory accounting treatment of losses from the sale of below-market rate mortgages will enable many S&Ls to convert loss-producing assets to profitable ones more quickly than is presently possible.

Revise DIDC Format

In passing PL 96-221, Congress charged the Depository Institutions Deregulation Committee with the task of conducting a gradual and orderly phase-out of Regulation Q interest rate ceilings over a six-year period. The Congress was clearly concerned about the existing competitive advantage of banks over thrift institutions and recognized that the new asset powers of thrifts could not improve thrift earnings and competitive posture for several years. The DIDC has chosen to ignore this legislative history and the fact that thrift earnings are severely strained while bank profits have fared very well in this chaotic economic environment.

The National League, therefore, urges Congress to amend Title II of PL 96-221 to restrict DIDC voting membership to the chairman of the FDIC, the Fed, and the FHLBB. The Treasury

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Secretary has no direct responsibility for the safety and soundness of regulated depository institutions and the NCUA chairman is free to ignore DIDC decisions. We also believe that because DIDC decisions bear directly on the financial viability of depository institutions that the Committee's decisions should be by unanimous vote.

Conclusion

In summary, Mr. Chairman, the National League urges this Committee and the Congress to view these restructuring issues with a sense of urgency. The financial marketplace is changing at a rapid pace with virtually unregulated entities offering services heretofore reserved to the regulated depository institutions. The deregulation of competition for deposit liabilities is virtually complete. Yet, as of today, the ability of traditional depository institutions to offer financial services demanded by the marketplace is still restrained by old statutes and regulations. Since it is highly unlikely that this Congress will or can return us to a tightly regulated financial market, the only viable course of action is to remove the asset constraints so that we can at least have a chance to meet the competition in the years ahead.

The CHAIRMAN. Mr. Masterton.

Mr. MASTERTON. Thank you, Mr. Chairman.

My name is Robert R. Masterton, chairman of the National Association of Mutual Savings Banks and president of the main savings bank in Portland, Maine.

We represent 455 savings banks, and I would like to summarize our statement, which is on file.

We are focusing on three areas: The need for broadened powers of thrift institutions; second, and simultaneously, the need to restrain the Depository Institutions Deregulation Committee; and third, the need to provide the regulators with greater flexibility in dealing with troubled institutions.

NAMSB urges immediate action to restrain the policies of the commercial institutions. They are on a precipitous rush to embark on deregulation at a time when the thrift industry is in dire straights, caused by the economic instability in general and interest rate instability specifically. Those policies are underscored by the actions taken and proposed at its meeting on December 22.

It is clear that they have failed to act in accordance with the congressional mandate to provide for an orderly phaseout of depository interest rate ceilings with due regard for the safety and soundness of depository institutions. The fact that the scheduled November 1 increase in the passbook ceiling rate has been deferred does not lessen the need for congressional action to restrain DIDC.

We urge, as a first step, the prompt adoption of a congressional resolution directing the DIDC to refrain from further depository deregulation and to postpone implementation of all its independent authority actions until the thrift industry is clearly out of serious danger and economic stability is achieved, as measured by stable interest rates.

Legislation is needed to restrain and restructure the DIDC, and we have specific recommendations to accomplish this in our complete statement.

BROADEN POWERS FOR THRIFT INSTITUTIONS

NAMSB strongly supports broadened powers for thrift institutions in order to assure their long-run competitive viability. In view of the DIDC's rush to deposit regulation and the dramatic changes occurring in the financial markets, it is essential that the Congress build upon the first step to broaden powers it took in the 1980 Deregulation Act, by providing federally chartered thrift institutions with the same powers which are available to commercial banks. This is basically the approach taken by the Financial Institutions Restructuring and Services Act of 1981, S. 1720; and by the administration-endorsed Thrift Institutions Restructuring Act of 1981, S. 1703; and the bill introduced by Senators Heinz and Tsongas yesterday, S. 1752. The broadened powers issue is of critical importance for our industry, and it is discussed in detail in our complete statement.

Let me emphasize, however, that broadened powers will not solve current thrift industry problems. Let it be clear, we are not making a claim that those powers will solve our current dilemma, but they will strengthen the ability of thrift institutions to compete in

future high-interest-rate periods as present low-yield mortgage portfolios are gradually turned over.

We recognize the concerns raised by some over the possible adverse effects that asset deregulation for thrift institutions might have on housing and mortgage markets. But the mere availability of commercial-bank-type powers will not transform thrift institutions into so many city banks.

It is not, in the case in other States, including my own in Maine, where powers have been available, commercial powers, to savings institutions since the mid-1970's. Our savings banks there have two-thirds of their assets invested in mortgages. Thrift institutions will not likely surrender their mortgage orientation and expertise. Mortgage credit will continue to remain a major community financial need, and thrift institutions will continue to meet that need.

As Secretary Regan has noted, broadened for thrift institutions will benefit housing and mortgage markets. By increasing flexibility and earning power, the supplemental powers will strengthen the ability of thrift institutions to pay competitive rates for savings and thereby have the funds to perform better their traditional mortgage lending functions.

When interest rates come down, as they will eventually, the benefits of fully flexible mortgage instruments in broadened secondary markets will also become increasingly apparent. Additional sources of mortgage credit will be developed and mortgage in housing markets will no longer be so heavily dependent, solely, on the thrift industry.

NAMSB supports more flexible authority for the Federal regulators to assist troubled thrift institutions. At the same time, the need for more flexible regulatory powers must be balanced carefully against the need to preserve interindustry competition between thrift institutions and commercial banks and to prevent unintended restructuring of the financial system.

With respect to financial assistance authority, the present 13(c) authority of the FDIC should be liberalized and made parallel to the FSLIC authority. This would be accomplished by the amended section 13(c) authority for the FDIC, contained in H.R. 4603, as adopted by the House Banking Committee.

We urge the Senate Banking Committee to include this provision in any legislation it develops.

NAMSB believes that broadened operating powers for thrift institutions and more flexible powers for the Federal regulators should be achieved in a single legislative package.

Accordingly, NAMSB supports the thrust of S. 1703, S. 1720, and S. 1413, the Regulatory Flexibility and Extended Powers Act of 1981, which has been introduced by Senator Tsongas.

Although there are differences, these bills provide a basis for developing a comprehensive legislative package needed to address immediate and longer run thrift industry problems.

NAMSB supports flexible chartering authority for Federal thrift institutions. We support maximum flexibility along the lines of S. 1703 and S. 1720.

In order to assure that conversion of a State-chartered savings bank into a thrift institution remains a practical reality, it is necessary to qualify the obligation of the FDIC to indemnify FSLIC

on the occasion of such a conversion. In this regard, we urge the committee to include in any legislation that it develops the indemnification provision contained in H.R. 4603, which was recently adopted by the House Banking Committee.

Consolidation of the Federal insurance funds, as proposed in S. 1721, would, of course, make the indemnification question a nonissue.

We believe S. 1721 is a proposal which merits further study.

NAMSB urges action to address the low-yield mortgage problem of thrift institutions. While broadened powers are essential to the longrun viability of thrift institutions, other actions are needed to address thrift institutions' shortrun problems, which arise fundamentally from the large holdings of low-yield mortgages.

As outlined in our complete statement, such action should include preemption estate laws prohibiting lenders from exercising due-on-sale clauses. They should also include a contingency program to be introduced at an appropriate time with the exchange of low-yield mortgages for variable-rate Federal agency obligations or other similar means.

In this connection, we support the broad due-on-sale preemption in S. 1720 and the provisions in S. 1720 and S. 1703, which would remove the limitation on the ability of the Federal Home Loan Mortgage Corporation and Fannie Mae to buy loans which are more than 1 year old.

We also support the Federal preemption of State usury ceilings on consumer credit, as provided in S. 1720.

There are other issues in our complete statement, which time does not permit us to address now.

As a concluding comment, we must note our industry's position, that any powers which are provided in banking legislation should be made uniformly available to thrift institutions and to commercial banks. I must respectfully disagree, therefore, with Secretary Regan's position, that expanded securities activities be extended to commercial banks only.

Thank you, Mr. Chairman.

[The complete statement follows:]

Statement
of the
National Association of Mutual Savings Banks
on
Thrift Institution Restructuring and Regulatory Flexibility
Before the
Committee on Banking, Housing and Urban Affairs
United States Senate
October 21, 1981

Mr. Chairman, my name is Robert R. Masterton. I am Chairman of the National Association of Mutual Savings Banks, and President of the Maine Savings Bank in Portland, Maine. The National Association represents the nation's 455 savings banks. Located in 17 states, savings banks are basically community-oriented financial institutions. In the areas where they are most heavily concentrated, savings banks are the largest holders of consumer savings as well as the dominant mortgage lenders among the various types of depository institutions. Our industry's total assets amount to \$175 billion.

We appreciate the opportunity to present the views of the savings bank industry on issues raised by the legislative proposals under consideration today, including S. 1703, S. 1720, S. 1721 and S. 1686, and by the very serious current problems of the thrift industry. Our statement will focus, in particular, on areas of critical importance to our industry: the need to restrain the Depository Institutions Deregulation Committee; the need to provide substantially broadened and more flexible powers for thrift institutions; and the need to provide the federal regulators with greater flexibility in dealing with troubled institutions.

You and your colleagues on the Banking Committee are to be commended, Mr. Chairman, for your initiatives in developing the Financial Institutions Restructuring and Services Act of 1981 (S. 1720), and for setting

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the legislative process in motion. We hope the result will be early actions by the Congress to strengthen thrift institutions and the regulatory process and to achieve more responsible policies by the DIDC. The savings bank industry stands ready to cooperate in every way in realizing these critically important objectives. The thrift industry is in the throes of its worst period since the Great Depression and the need for actions to meet its problems is of the greatest urgency.

Summary of Savings Bank Industry Position

At the outset, we would like to summarize the position of the savings bank industry on the interrelated issues of restraining the DIDC, providing broadened powers for thrift institutions and increasing the federal regulators' flexibility to assist troubled thrift institutions. Prompt and simultaneous action in these areas is essential to deal in a comprehensive way with both the immediate and the longer-run problems of savings banks and other thrift institutions.

(1) NAMSB urges immediate action by the Congress to restrain the harmful policies of the Depository Institutions Deregulation Committee. The DIDC is embarked on a precipitous rush to deregulate deposit interest rates at a time when the thrift industry is in dire straits. Its actions have seriously aggravated current problems. If unchecked, the DIDC's policies will have grave consequences for thrift institutions, mortgage and housing markets and overall economic and financial stability in this country.

Congressional action is urgently needed to avert the increasingly serious situation arising from DIDC actions. The first step should be a resolution of the Congress instructing the DIDC to refrain from further

deposit deregulation until the thrift industry is clearly out of serious danger, and until the Congress acts on legislation to broaden thrift institution powers. Legislation is also needed to restrain and restructure the DIDC, as recommended later in this statement.

(2) NAMSBS strongly supports broadened powers for thrift institutions in order to assure their long-run competitive viability in an environment of rapid deposit deregulation and financial market change. This long-standing position of our industry was reflected in NAMSBS's strong support of the Depository Institutions Deregulation and Monetary Control Act of 1980, which took an important first step in providing the broadened powers thrift institutions will need in a "Q-less" environment.

In enacting this legislation, the Congress clearly intended to strike a reasonable balance between gradual deposit deregulation and broadened, but still limited, thrift institution powers. The hoped-for balance has been shattered, however, by the haste of the DIDC in moving toward deposit deregulation, without sufficient concern for the current and longer-run problems of the beleaguered thrift industry. To restore a balanced approach, the Congress should act immediately to restrain the DIDC and to provide broadened powers for thrift institutions.

It is essential that the Congress build upon the first step to broadened powers it took in the Deregulation Act by providing federally-chartered thrift institutions with the same powers which are available to commercial banks. This is basically the approach taken by S. 1720 and by the Administration-endorsed Thrift Institutions Restructuring Act of 1981 (S. 1703), an approach our industry strongly endorses.

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(3) NAMSB believes that the authority of the federal regulators to assist troubled thrift institutions should be amended to provide the additional flexibility required by current conditions. Existing authority in this area was adopted years ago under radically different financial market conditions. There is a clear need to provide the federal regulators with updated powers to deal with present-day problems, and especially to provide the FDIC with expanded Section 13(c) assistance authority.

At the same time, the need for more flexible regulatory powers must be balanced carefully against the need to preserve inter-industry competition between thrift institutions and commercial banks. Otherwise, there is a danger that expanded regulatory powers could become the vehicle for unintended restructuring of the financial system and a reduction in competition.

To safeguard against this possibility, and to assure equal treatment for all institutions, there should be complete parallelism between the powers of FSLIC and FDIC, and among different types of institutions, with respect to financial assistance and acquisitions. We will present specific recommendations to achieve these results later in this statement.

(4) NAMSB believes that broadened operating powers for thrift institutions and more flexible powers for the federal regulators should be achieved in a single legislative package. The current and longer-run problems of thrift institutions are interrelated and should be addressed simultaneously. This would enable the regulators to provide more effective assistance to currently troubled institutions, while laying the foundation for a strengthened and more competitively viable thrift industry. It is our industry's position that broadened powers for thrift institutions should be included in banking legislation being considered by the Congress.

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Accordingly, NAMS8 supports the thrust of S. 1703, S. 1720, and S. 1413, the Regulatory Flexibility and Expanded Powers Act of 1981 which has been introduced by Senator Tsongas. While there are differences, these bills combine expanded powers for the federal regulators and broadened powers for thrift institutions, and therefore provide a basis for developing the comprehensive legislative package needed to address immediate and longer-run thrift industry problems.

With this summary of our industry position in mind, we would like to comment on these issues in greater detail, and also comment on some other issues under consideration today.

Restraining the DIDC

As we have noted, Mr. Chairman, the DIDC is embarked on a rush to deposit deregulation, without sufficient concern for the troubled state of the thrift industry. The September 22 actions of the DIDC -- including proposed "new" ceiling-free accounts and an increase in the passbook rate ceiling, effective November 1, which we hope will now be deferred -- are merely the latest example of the harmful policies pursued by the Committee since it was established by the 1980 Deregulation Act.

The actions and proposals of the DIDC on September 22 would more than offset the benefits of the All Savers Certificate for thrift institutions. It was only after the most vigorous representations of the thrift industry that Treasury Secretary Donald Regan, the present Chairman of the DIDC, announced that he would seek to have the scheduled increase in the passbook rate ceiling deferred. The Secretary's announcement does not lessen the need for Congressional action to restrain the DIDC.

It is clear that the DIDC has failed to act in accordance with the Congressional mandate to provide for the "orderly" phase-out of deposit interest rate ceilings "with due regard for the safety and soundness of

depository institutions." This is underscored by the serious condition of the thrift industry at the time DIDC took its September 22 actions.

Thus, in the first eight months of this year, savings banks suffered an aggregate \$9.5 billion net outflow of deposits before crediting interest. This exceeded by far the all-time record outflow for a full calendar year of \$7.0 billion registered in 1979. And large-scale deposit outflows continued in September.

At the same time, earnings positions have continued to deteriorate. In July, savings banks suffered an industrywide bottom-line loss equivalent to 120 basis points on assets at an annual rate, compared with an annualized loss of 56 basis points in the first half of the year. Additional large bottom-line losses have been registered since then, and earnings will remain under pressure in 1982, even with the All Savers Certificate.

Savings and loan associations, of course, have been experiencing similar problems. The All Savers Certificate will be helpful, but pressures on thrift institutions will continue as long as interest rates remain in the stratosphere.

NAMSB expressed its deep concern over the policies of the DIDC in a letter sent to each member of the Senate and House Banking Committees on September 28, with copies to every Senator and Congressman. As stated in that letter, and at the outset of this statement, we believe that Congressional action is urgently needed to avert an increasingly dangerous situation arising from DIDC actions.

The first step should be a Congressional resolution instructing the DIDC to refrain from further deposit deregulation until thrift institutions are clearly out of danger and until the Congress acts on legislation to broaden thrift institution powers. We respectfully suggest that the resolution should

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make clear the view of the Congress that the DIDC has proceeded too rapidly with deposit deregulation, that it has not paid sufficient attention to the serious problems of the thrift industry, that it is endangering the safety and soundness of many institutions, that broadened powers are a necessary prerequisite for deposit deregulation, and that powers in addition to those provided in the 1980 Deregulation Act are necessary. The resolution should also specifically instruct the DIDC to rescind the actions proposed or taken at its September 22 meeting.

In addition to a resolution of the Congress, legislative action is also needed to restrain the DIDC and to assure that it acts more responsibly in the future. This should include:

(1) Restating the DIDC's legislative mandate to provide greater emphasis on assuring the safety and soundness of depository institutions. The 1980 Deregulation Act should be amended to make it crystal clear that deposit deregulation must be implemented in a way that will not endanger the safety and soundness of depository institutions, with particular recognition given to the problems of thrift institutions which are most vulnerable to high interest rates because of their large low-yield mortgage portfolios.

(2) Restructuring the membership of DIDC. Consistent with increased emphasis on the safety and soundness of depository institutions, the membership of the DIDC should be restricted to the Chairman of the FDIC, the FHLBB/FSLIC and the Federal Reserve. These are the agencies directly responsible for assuring the safety and soundness of the thrift institutions and commercial banks which are subject to DIDC regulation -- the FDIC and FHLBB/FSLIC through the deposit insurance function and the Federal Reserve through its role as the lender of last resort.

It is inappropriate for the Chairman of the National Credit Union Administration to be a member of the DIDC, because credit unions are not subject to DIDC regulation and are direct competitors of the institutions regulated by the DIDC. The Secretary of the Treasury has no direct regulatory responsibilities over depository institutions. It is inappropriate, moreover, for any Department of the Executive Branch to vote on decisions affecting institutions which are regulated by the independent agencies created by the Congress.

(3) Requiring unanimous agreement among the DIDC members in any deregulation action. This would reinforce safeguards against any actions which might adversely affect the safety and soundness of any class of depository institution.

(4) Requiring immediate restoration of the 6-month money market certificate differential for thrift institutions at all levels of interest rates. The benefits of broadened powers will take time to be realized. Immediate restoration of the MMC differential is a critically important step that can be taken now to meet thrift industry problems.

(5) Extending statutory protection for the thrift institution differential to all types of accounts. As long as deposit rate controls are in effect, a differential should be available on all types of accounts of less than \$100,000, whether they were in existence before or after December 1975, except for the All Savers Certificate created by Congress. This would help redress the existing competitive imbalance between thrift institutions and commercial banks and prevent any possibility of eliminating the differential through the device of creating "new" types of accounts, as presently proposed by the DIDC.

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This program would directly address the major problems created by the DDC's policies. It would provide needed safeguards against precipitous deposit deregulation in the present climate. At the same time, it would provide the foundation for a strengthened thrift industry which can compete on even terms in deregulated markets in the future. In sum, it would restore and promote the balanced approach to deregulation contemplated in the 1980 Deregulation Act, an approach which has been shattered by the DDC's policies.

We hope that this Committee will take the lead in implementing such a program.

Broadened Thrift Institution Powers

We would now like to turn to the issue of broadened powers for thrift institutions. The need to provide thrift institutions with broadened and more flexible powers is widely recognized. The savings bank industry has long advocated this balanced approach to thrift industry restructuring, emphasizing that deposit deregulation must be accompanied by deregulation on the assets side of the balance sheet. Unfortunately, this balanced approach has not been fully implemented, even as the need for expanded asset powers has become increasingly apparent.

As noted previously, the Congress took an important first step in this direction in the expanded powers for federal savings institutions provided in the 1980 Deregulation Act, including limited commercial lending and limited business demand deposit authority for federal savings banks. Enactment of "parity legislation" at the state level has since extended these powers to most state-chartered savings banks. At the same time, the Federal Home Loan Bank Board has authorized fully flexible mortgage lending authority for federal thrift institutions in its adjustable mortgage loan regulation.

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These are encouraging developments. But they are not sufficient to meet the accelerating competitive challenges from many different quarters that thrift institutions face now, and will face increasingly in the future. To meet these challenges, and to compete effectively in a "Q-less" environment, thrift institutions must have the same operating powers and flexibility as commercial banks. The Congress should act now to provide these powers for federally-chartered thrift institutions, while recognizing that their implementation by individual institutions will necessarily take some time. The critical need today is to begin to restore balance to the present seriously unbalanced deregulation process by restraining the DIDC and by providing expanded asset and operating powers to thrift institutions.

Support for broadened powers. The need for broadened powers has been emphasized by the Administration, most recently in Treasury Secretary Donald Regan's testimony before this Committee on October 19. In previous testimony before this Committee last April 28, Secretary Regan also clearly stated the Administration's position, as indicated in these excerpts from his April statement:

"We believe all depository institutions should have equal powers and should be free to choose whatever specialization they wish, based on their individual competitive skills and goals."

"The Deregulation Act of 1980 authorized all Federally chartered thrift institutions to make consumer loans and savings banks to make commercial loans under certain limited conditions. The Administration favors expansion of these powers to allow all depository institutions to make the same type of loans in whatever amount they see fit." (emphasis supplied.)

"The most pressing need at this time is for further decontrol of asset powers, to enable depository institutions to better utilize the high cost deposits that go with high inflation rates."

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"On December 31, 1980 all depository institutions were authorized to offer Negotiable Order of Withdrawal accounts... it seems appropriate to go the next step and authorize all depository institutions to accept demand deposits." (emphasis supplied.)

On October 1, in announcing that the Administration has endorsed the Thrift Institutions Restructuring Act of 1981 (S. 1703) developed by the Federal Home Loan Bank Board, Secretary Regan again stated the Administration's position:

"The thrift industry has suffered repeatedly during periods of high interest rates... While the proposed new powers would not exceed those of commercial banks they should give the industry more flexibility to deal with any economic environment. In turn, this should enhance the industry's ability to finance housing, its principal activity. the structure of American financial institutions must be modernized to reflect the demands of the current marketplace. Because of its recurring difficulties the thrift industry is especially in need of modernization..."

Substantially broadened powers for thrift institutions have also been strongly endorsed by the Federal Home Loan Bank Board, as reflected in the Thrift Institutions Restructuring Act of 1981 which the Bank Board has developed. In remarks before the National Press Club on September 10, Chairman Richard Pratt of the Bank Board, in referring to thrift industry problems and to this proposed legislation, stated:

"While the enactment of the all savers certificate provides some immediate assistance to the industry is imperative that the structural changes required be addressed. This will entail a virtual rewrite of the statutory authority governing thrifts to permit them to choose the line of business they will be in and to compete on a level playing field with other providers of financial services. To do this, we are proposing the Thrift Institutions Restructuring Act, or the 'Powers Bill.'"

The views of Secretary Regan and Chairman Pratt on the need to provide broader powers for thrift institutions are fully consistent with the position of the savings bank industry. Last year, I was privileged to serve as Chairman of NAMS's Special Committee on Future Directions for Savings

Banking, which considered the question of broadened powers in great detail. I can think of no better way to indicate our industry's views than to quote this major conclusion of the Committee's December 1980 report:

the fundamental mission of savings banks in the 1980s is to be fully competitive in providing financial services and in attracting funds for productive investment, to the ultimate benefit of their depositors their communities and the nation as a whole. To realize this mission savings banks must have sufficient earning power to compete for savings and serve a variety of community needs. They must also have maximum flexibility to attract funds from the widest possible range of sources maximum flexibility to channel these funds into the widest possible range of investments, and maximum flexibility to provide the widest possible range of financial services to the public."

Broadened powers and the role of thrift institutions. Flexibility is the key. And that is why savings banks must have the same powers as are available to commercial banks. We seek these powers not for their own sake, and certainly not to become commercial banks. We seek them, rather, because they will maximize flexibility and institutional choice. The ability to make business loans, to accept demand deposits from any source and to provide other banking services will be an important supplement to existing thrift institution powers. By increasing flexibility and earning power, these supplemental powers will increase the ability of thrift institutions to pay competitive rates for savings and thereby have the funds to perform better their traditional mortgage lending function.

We recognize that individual institutions may not wish to use every power that is available. For most institutions this would be neither desirable nor practical. But the ability to choose which powers and services to offer should be available, so that each institution can respond effectively to the challenges and opportunities of its own circumstances. The critical point is that mandated specialization on the assets side of the balance sheet is inconsistent with deposit deregulation on the liabilities side.

Another critical point also deserves special emphasis: broadened powers along the lines provided in S. 1703 and S. 1720 will not change the basic consumer and community orientation of thrift institutions. There will be greater diversification, but also increased scope and ability to meet mortgage credit and other consumer financial needs.

The mere availability of commercial-bank-type powers will not transform thrift institutions into so many Citibanks. The availability of such powers certainly has not done so for the thousands of community commercial banks throughout the nation. It has not done so for those savings banks which have long had commercial-bank-type powers. And it will not do so for the thrift institutions which would now be authorized such powers.

Thrift institutions still must serve their local markets and provide the financial services required by their customers, whatever powers are available to them, if they are to be competitive and grow. Mortgage credit clearly will remain a major consumer and community financial need, and one that thrift institutions will continue to meet. Thrift institutions will not lightly surrender their mortgage orientation and expertise.

We recognize the concerns that some have raised over the possible adverse effect that asset deregulation for thrift institutions might have on housing and mortgage markets. But the solution to the housing credit problem is not to keep thrift institutions in a specialized straitjacket. This would hardly help housing and mortgage markets, since thrift institutions would increasingly be unable to attract funds for mortgage lending.

The current problems of thrift institutions in today's climate of rapid inflation and sky-high interest rates stem directly from their past mandated specialization in mortgage lending. Heavily burdened with portfolios of low-yield, long-term, fixed-rate mortgages, thrift institutions are unable

to increase their earnings in line with the soaring cost of their funds, which are increasingly tied to market rates. Nor are they able to compete for savings with money market mutual funds and open-market investments in today's financial climate. The results of this situation are all too well known -- massive deposit outflows, deepening bottom-line losses on income statements, growing pressures on liquidity and net worth positions.

Broadened powers will not solve current thrift industry problems, but they will strengthen the ability of thrift institutions to compete in future high-interest-rate periods as present low-yield mortgage portfolios are gradually turned over. And as Secretary Regan has noted, a strengthened and more competitive thrift industry would be strongly in the best interest of housing and mortgage markets.

Not only will thrift institutions be able to serve the mortgage market better. At least of equal importance are the dramatic improvements in the mortgage instrument and in the mortgage market that are now taking place. These have been obscured by high interest rates. But when rates come down, as they will eventually, the benefits of fully flexible mortgage instruments and broadened secondary markets will become increasingly apparent.

Additional sources of mortgage credit will be developed. The mortgage and housing markets will no longer be so heavily dependent, as they are today, on the thrift industry. They should thus become better and more efficiently served by a broadened credit base.

Ultimately, of course, the real solution to the problems of thrift institutions, and of housing and mortgage markets, is success in the fight against inflation. We hope the Administration's program will succeed. In the meantime, thrift institutions must be given the powers they need to meet the

challenge of a growing array of competitors over all stages of the interest rate and business cycles if they are to continue to serve this nation's savers and mortgage borrowers effectively.

Benefits of broadened powers. Providing broadened powers for thrift institutions clearly would be beneficial for the saver, because more flexible and profitable powers will enable thrift institutions to generate the earnings needed to pay increased returns to savers. And the strengthened ability to attract funds will, in turn, strengthen the ability of thrift institutions to serve the mortgage borrower, as noted previously.

But the benefits of broadened thrift institution powers will extend far beyond the individual saver and mortgage borrower. Strengthening thrift institutions will reinforce policies to promote noninflationary economic growth and community revitalization throughout the nation. We cannot hope to rebuild our industrial base and revitalize our communities unless we can generate a massive volume of private capital. As capital-generating, capital-investing, community-oriented institutions, savings banks are ideally suited to play a major role in future economic and community revitalization efforts, as they have in the past.

This role is being frustrated in today's economic environment, and by present limitations on savings bank powers. Broadened powers will be essential for savings banks to fulfill this role in the markets of the 1980s and beyond.

The Types of Powers Needed

As stated previously, it is our industry's position that savings banks should have the same powers as are available to commercial banks. Accordingly, NAMSBS urges that the statutory powers of federal savings banks be amended as follows, generally in line with the provisions of S. 1703, S. 1720, and S. 1413.

Commercial lending authority. The commercial lending authority of federal savings banks should be amended in light of the experience gained since enactment of the 1980 Deregulation Act. Current law restricts commercial loans to 5 per cent of the institution's assets. It also requires that such loans be made only within the state where the bank is located or within 75 miles of the bank's home office. The 5 per cent ceiling and geographic limitations should be eliminated in order to make commercial lending authority a practical reality.

Some institutions may soon bump up against the 5 per cent limit and will, for practical purposes, be forced to curtail future commercial lending activity. Other institutions are inhibited from entering the commercial loan market because the presently permitted volume of lending may be economically insufficient to absorb the additional costs necessarily involved in undertaking a new activity of this type. Furthermore, the geographic limitation needlessly restricts commercial lending opportunities and is contrary to long-standing public policy which encourages the free flow of credit to areas of greatest need.

The Community Reinvestment Act and Federal Home Loan Bank Board supervision will continue to act as safeguards to ensure that local needs for mortgage and other credit are met. In addition, federal savings banks should be subject to the same provision applicable to national banks with respect to limits on commercial loans to any single borrower.

Demand deposit authority. Federal savings banks are currently authorized to accept business demand deposits only "in connection with a commercial, corporate or business loan relationship." Federal savings banks

should be permitted to accept demand deposits from any source. This would clearly be consistent with the recent action of the Congress in authorizing NOW accounts for all types of depository institutions. As a result of the proposed change, consumers would have the opportunity to obtain the same transfer of funds services from federal savings banks that are available from commercial banks. Federal savings banks would also be able to compete for business and government demand deposits on the same terms as commercial banks. Such increased competition would clearly be beneficial to all users of demand deposits.

Investment authority. The investment authority of federal savings banks should be updated in light of ongoing financial developments. Under present law, a ~~state-chartered~~ savings bank converting to a federal charter may continue to carry on any activities it was engaged in on a specified date -- December 31, 1977. Such a converting institution is also authorized to retain or make any investment of a type it held on that date, except that its equity, corporate bond, and consumer loan investments may not exceed the average ratio of such investments to total assets for the five-year period immediately preceding the filing of an application for conversion. The December 31, 1977 date should be changed to the date immediately prior to conversion and the 5-year average limitation should be deleted.

The December 31, 1977 cut-off date is increasingly obsolete in view of the dynamic changes in financial services, investments and technology affecting all types of institutions. There is no reason to hold a federal savings bank organized now or in future years to the particular activities and investments which it happened to engage in as of December 31, 1977.

Similarly, the limitation on equity, corporate bond and consumer loan investments looks backward rather than forward, and may have little relationship to investment opportunities and borrower demands in future years. Both restrictions are inconsistent with the thrust of the 1980 Deregulation Act which mandates the phase-out of deposit interest rate ceilings in an environment of liberalized investment authority. In keeping with a basic safeguard of the federal savings bank provision, however, the investment powers of these institutions will continue to be exercised only to the extent authorized by the chartering agency, the Federal Home Loan Bank Board.

Service corporations. Authority to invest in service corporations should be increased to more economically feasible levels and made parallel for federal savings banks and federal savings and loan associations. Current law authorizes corporations jointly owned by savings and loan associations to invest in service corporations. There should be parallel authority for federal savings banks. At the same time, the service corporation investment authority for both types of institutions should be increased from 3 per cent to 10 per cent of an institution's assets. Furthermore, the requirement that a portion of this authority should be used for community, inner-city and community development purposes should be deleted in order to provide maximum flexibility in its use.

Investment in foreign branches and foreign banks. In order to provide parallel treatment and competitive equality, federal savings banks should be authorized to operate branches in foreign countries and to invest in United States and foreign corporations engaged in international or foreign

banking. This authority would be subject to the same regulatory treatment applied by the Federal Reserve Board to national banks. In an environment of rapid deposit deregulation, there is no reason to deny federal savings banks the same powers currently available to thousands of national banks, both large and small.

Bank holding company powers. Federal savings banks should be able to carry on all activities authorized to bank holding companies, as the Federal Home Loan Bank Board defines such powers. This is consistent with the intent of the Congress in granting federal savings banks the authority to make commercial loans and accept business demand deposits. Since federal savings banks are authorized to engage in what was once exclusively a commercial bank preserve, they should not be barred from the useful and profitable activities carried on through bank holding companies. As is true of other proposed amendments, this authority is needed to enable federal savings banks to compete with commercial banks in rapidly deregulated deposit markets.

Other powers. Finally, NAMSBA endorses other provisions in S. 1703 and S. 1720 which would expand lending and investment options for federal savings banks.

Both S. 1703 and S. 1720 would go a long way toward providing the necessary broadened powers for federal savings banks, as would S. 1413. We hope our comments will be useful as the Committee proceeds to develop legislation in this critical area.

Before turning to the issue of expanded assistance authority for the federal regulators, we would like to comment on two other areas that are related to the broadened powers issue. The first is proposed changes in

chartering authority for federal thrift institutions, an area addressed by S. 1703 and S. 1720. The second is the very serious low-yield mortgage problem of thrift institutions.

Chartering Authority for Federal Thrift Institutions

With respect to chartering authority for federal thrift institutions, we have three recommendations:

(1) The Federal Home Loan Bank Board should be authorized to charter federal savings banks de novo or through conversion of federal savings and loan associations, in all 50 states This proposal recognizes that enactment of the broadened powers provisions of S. 1703 and S. 1720 would essentially eliminate differences of authority between federal savings banks and federal savings and loan associations. As a result, the current requirement that federal savings banks can only be organized through the conversion of a state mutual savings bank becomes wholly artificial and meaningless. Institutions with the same powers should be allowed to operate under the same chartering authority if they wish.

(2) The current prohibition against the conversion of a federal mutual savings bank into a stock institution should be eliminated. Consistent with the need for the widest possible financial service options, federal savings banks should have the option to operate under either the mutual or stock form. Both corporate forms have advantages and disadvantages, which can be realistically appraised only by each individual institution.

In broader terms, NAMSBS supports the provisions in S. 1703 and S. 1720 which would permit any institution that is a Federal Home Loan Bank member, or which is eligible to become a member, to convert into either a

federal savings bank or federal savings and loan association, and to adopt either the stock or mutual form. We also support granting authority to the Federal Home Loan Bank Board to charter such institutions de novo.

These provisions would be consistent with the recent recommendation of NAMSB's Special Committee on Capital Adequacy that a federal stock chartering alternative should be available to savings banks. In endorsing this recommendation, NAMSB's Board of Directors concluded that maximizing flexibility and choice for individual savings banks should encompass corporate form as well as powers and types of services offered.

(3) In order to assure that the conversion of a state-chartered savings bank into a federal thrift institution remains a practical reality, it is necessary to clarify the obligation of the FDIC to indemnify FSLIC on the occasion of such a conversion. In this regard, we urge the Committee to include in any legislation that it develops the indemnification provision contained in H.R. 4603, which was recently adopted by the House Banking Committee.

At present, the indemnification issue is effectively preventing action by the Federal Home Loan Bank Board on applications for federal savings bank charters. Resolution of this issue is especially important in the context of S. 1703 and S. 1720, since the broadened powers provided by these bills would apply only to federally-chartered thrift institutions.

Consolidation of the federal deposit insurance funds as proposed in S. 1721 would, of course, make the question of indemnification a non-issue. We believe S. 1721 is a proposal which merits serious further study.

Addressing the Low-Yield Mortgage Problem

While authorizing broadened powers is essential to the future viability of thrift institutions, other actions are needed to address the root

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cause of current short-run problems -- large holdings of long-term, fixed-rate mortgage loans acquired in earlier low-interest-rate periods. The All Savers Certificate is a badly needed measure to alleviate disintermediation and bottom-line pressures. At this point, however, the precise effect of the All Savers Certificate is uncertain. And the All Savers Certificate will be temporary in any event. The following actions should be taken, therefore, to relieve earnings pressures by encouraging the roll-over of existing low-yield mortgage portfolios:

— Pre-emption of state laws prohibiting lenders from exercising due on sale clauses in mortgage contracts, as provided in S. 1703 and S. 1720

— Changes in regulatory accounting rules to permit institutions to defer and amortize gains and losses on long-term assets, as adopted by the Federal Home Loan Bank Board; and

— A contingency program, to be introduced at an appropriate time, for the exchange of low-yield mortgages for variable-rate federal agency obligations or other similar means.

With respect to the due on sale preemption, we endorse the approach taken in S. 1720, which would apply to all depository institutions and to HUD-approved lenders. This preemption should have the widest applicability in order to promote the critically important roll-over of low-yield mortgage portfolios. And, of course, we support the federal preemption of state usury ceilings on consumer credit, as provided in S. 1720.

Emergency Powers of the Federal Regulators

As indicated earlier, the federal regulators should have the necessary flexibility to deal with troubled institutions, with respect to both

financial assistance and acquisitions. In important respects, current powers are outdated and vary between the agencies. In amending the emergency powers of the regulators, therefore, it is important that certain basic principles be observed.

(1) FDIC and FSLIC should have completely parallel emergency powers, both in substance and language. The current powers of the FSLIC to provide financial assistance to troubled institutions are more liberal than those of the FDIC. This problem is highlighted by the recent assisted mergers approved by the Federal Home Loan Bank Board, including a three-state merger which created the largest ~~federally-chartered~~ thrift institution in the United States. Whatever may be the historical basis for differences in the emergency powers of FDIC and FSLIC, there is no justification for their perpetuation.

In particular, the present more narrow Section 13(c) authority of the FDIC to provide financial assistance should be liberalized and made parallel to FSLIC authority. This would be accomplished by the amended Section 13(c) authority for the FDIC contained in H.R. 4603, as adopted by the House Banking Committee. We urge the Senate Banking Committee to include this provision in any legislation it develops.

Our industry has long urged the FDIC to use its powers to assist troubled institutions, as the FSLIC has done. We would hope that expanded Section 13(c) authority would result in greater willingness of the FDIC to provide assistance to institutions which may be experiencing difficulties in the present financial climate.

(2) Financial assistance should take precedence over involuntary combinations within or across state or industry lines. The remedy of capital infusion should be considered first before extraordinary acquisitions, which should be authorized only after all other possibilities have been exhausted, and the regulators should be required to make a finding as to their reasons for rejecting capital infusion in favor of an involuntary combination. This would be consistent with current branching and merger laws governing banks, as well as with the need to preserve inter-industry competition between thrift institutions and commercial banks. Absent basic changes in branching and merger laws, involuntary combinations across state and industry lines should be an "extraordinary" event, a last resort which takes place only if other remedies are not feasible. The use of emergency powers by the regulators should not be the vehicle for a basic restructuring of the financial industry, which is the prerogative of the Congress.

(3) In the case of involuntary combinations, a specific schedule of priorities should be adopted and should apply uniformly to savings banks, savings and loan associations and commercial banks Specifically, the insuring agencies should seek combinations involving: first, institutions of the same type in the same state; second, institutions of the same type in different states; third, institutions of different types in the same state; and fourth, institutions of different types in different states. As in the case of the preferred method of capital infusion, this schedule of priorities is designed to preserve inter-industry competition and is in line with the general thrust of existing branching and merger laws.

(4) Authority to acquire other types of institutions should be equally available to commercial banks and thrift institutions. Thus, if

commercial banks are permitted to acquire savings banks on an inter-state or intra-state basis, reciprocal authority should be available to savings banks. This principle of parity is also intended to preserve inter-industry competition and clearly is needed to assure equal treatment of thrift institutions and commercial banks.

As emphasized at the outset of our statement, prompt action to expand the emergency powers of the federal regulators and to broaden the operating powers of thrift institutions is essential. These dual objectives, which address both the current and longer-run problems of the thrift industry, should be achieved in a single legislative package, along the lines of S. 1703, S. 1720 and S. 1413.

Other Issues

Finally, we would like to comment briefly on other issues which have been raised in connection with these hearings. The first issue relates to our concerns over Section 178 of S. 1720 and Section 508 of S. 1703, essentially identical provisions dealing with changes in Federal Home Loan Bank membership.

At the present time, membership in the Federal Home Loan Bank System is optional for state-chartered mutual savings banks. Nevertheless, 140 savings banks were members of the System as of December 31, 1980, and have purchased the requisite amount of stock to become eligible to join. However, these sections of S. 1720 and S. 1703 would provide that:

(1) If a state-chartered mutual savings bank availed itself of the option to join and later concluded that its best interests would be served by withdrawal from the System, it could never again become a member in any

Federal Home Loan Bank, unless it abandoned its present deposit insurance and became insured by the Federal Savings and Loan Insurance Corporation.

(2) No state-chartered mutual savings bank could become a member of the Federal Home Loan Bank System after the later of December 31, 1987, or five years after the date of receiving its charter, unless it abandoned its present deposit insurance and applied for insurance from FSLIC.

These provisions are a most undesirable attempt to restrict the rights of state-chartered institutions by penalizing them for a good faith judgment to withdraw from the System and by banning them from applying for membership entirely, unless they agree to FSLIC insurance. Voluntary membership in the Federal Home Loan Bank System for state-chartered savings banks has never been conditioned on insurance from FSLIC. It should also be noted that life insurance companies are also eligible to join the System, and of course they are not depository institutions eligible for deposit insurance.

We do not believe that state-chartered savings banks should be forced to adopt FSLIC insurance as a condition for membership in the Federal Home Loan Bank System. Other, less drastic means are potentially available to meet any perceived problem of "in and out" membership. Our industry would be happy to cooperate in such an effort. Accordingly, we urge that Section 178 of S. 1720 and Section 508 of S. 1703 not be included in any legislation developed by this Committee.

On another issue, the NOW account originated in the savings bank industry and we have long supported its widespread availability. Accordingly, we support that provision of S. 1686 which would make state and local government entities eligible to maintain NOW accounts.

Finally, Mr. Chairman, it is our industry's position that any powers which are provided in banking legislation should be made uniformly available to thrift institutions and commercial banks. In this regard, we must respectfully disagree with Secretary Regan's position that expanded securities activities be extended to commercial banks only. If the Congress decides to permit commercial banks to provide a money market mutual fund service, for example, then such a service should also be made available to thrift institutions.

Conclusion

In conclusion, Mr. Chairman, the savings bank industry urges prompt Congressional action to restrain the DIDC and to provide broadened powers for thrift institutions and more flexible emergency powers for the federal regulators. We believe that the broadened powers/emergency powers issues should be addressed in a single legislative package. We commend the bipartisan initiatives of the Banking Committee in addressing the growing problems of the thrift industry. We hope that our statement will be helpful to the Committee as it develops legislation to strengthen thrift institutions and the regulatory process.

The CHAIRMAN. Mr. Wood.

Mr. WOOD. Thank you, Mr. Chairman.

My name is John R. Wood. I am a realtor, with a small office in Naples, Fla., and president of the National Association of Realtors.

I appreciate this opportunity to appear before you today to present our concerns and, we believe, those of the American homebuying public regarding various proposals to restructure financial institutions.

Typically our concerns and those of other witnesses testifying at hearings such as this are expressed in broad economic terms. Unfortunately, our membership and the consuming public must view today's economic problems and their solutions in human terms.

The solutions proposed by the administration, the Federal Home Loan Bank Board, and this committee, we believe, will not be responsive to a public desperately in need of understandable solutions which explain why they cannot afford even the most basic shelter.

The facts speak for themselves: The demand for shelter is at an alltime high; we are in the worst housing recession since World War II; there is a rental housing crisis of major proportion which

further denies frustrated potential home buyers access to minimal rental accommodations; and affordability problems are changing family formation patterns, forcing doubling up, delaying marriage and even childbearing.

Succintly stated, proposals to dismantle the few remaining elements of this Nation's housing financial delivery system, with no assurance that the private sector will be able or even willing to meet this challenge, leaves only the hope that a recovering economy will produce the solution. Public perceptions are far too basic to comprehend such a response.

What the public does see is this kind of example: In your home State, the Hong Kong & Shanghai Banking Corp.—through its subsidiary, the Marine Midland Bank of New York—determines the terms and flow of credit of all kinds, for every community and every individual. We are deeply concerned with the rising tide of conglomerates and do question their ability to be responsive to all local needs.

We are unable to support the Chase Manhattan's determining flow of credit and loan policies for small banks in the small communities of our Nation.

The economic health of our Nation's communities is sustained by viable, small business of all kinds. They represent employment, community service, and effective distribution of goods and services—in short, they are our communities.

Our membership is a part of the fabric of the small business community with over 80 percent represented by single office operations. Their livelihood depends on their responsiveness to the needs and desires of your individual constituents. Their clear message to us, here in Washington, is that big business is not necessarily better business and they do not see the proposals before us today as addressing the most basic problems.

They view these problems as concentration of credit in the control of a few; loss of individual ability to compete in capital markets for mortgage credit; dislocation and potential dissolution of the fabric of small business communities; and a disillusioned public incapable of resolving their growing frustration.

LEGISLATION COULD CAUSE DAMAGING EFFECT

Mr. Chairman, we applaud your efforts to attempt to address new market realities. Unfortunately, our membership does not believe that what has been proposed will effectively respond to the serious concerns of homeowners and potential homeowners. In particular, we believe that if the legislation before your committee were enacted, it could have a most damaging effect to a large segment of the small business community and ultimately all homeowners.

You are now asking the financial- and housing-related industries to consider sweeping new legislative proposals before any of the financial institutions have had the opportunity to digest the expanded powers they received only last year. The premise of the proposed legislation is that thrifts can survive in the long term only by abandoning their housing responsibility.

We strongly disagree with the premise which ignores recent actions that will mitigate the short- and long-term earnings prob-

lems of the thrift industry. These actions include substantial injections of low-cost money through the all-savers certificate; amortizing the loss from the sale of low-yielding mortgages over the life of the loan; secondary market options for the sale of low-yielding mortgages; thrift access to the Federal Reserve discount window.

And most importantly, the instrument of future transactions, adjustable rate mortgages, which will once again make mortgage lending profitable. With adjustable rate mortgages, thrifts should never again be required to lend long and borrow short.

The legislation being discussed today may well be the best way to make existing depository institutions more competitive with the new participants in the financial services marketplace. That, in and of itself, is a worthy goal, but the costs associated with it may far outweigh the benefits.

The net effect of the legislation would be the dismantling of our housing finance delivery system; the further encouragement of anticompetitive vertical and horizontal integration of small business, such as real estate, through financial holding companies; the loss of local decisionmaking by opening the door for interstate branching and concentration; the destruction of the only practical way homes are financed today by denying mortgage assumption through a Federal preemption of State due-on-sale options.

While we are attempting to devise broad actions by our Federal Government to solve our economic ills, individual people-oriented solutions are being developed in local markets. Yet, the proposals before us today would effectively prohibit some of those solutions.

For example, creative financing techniques utilizing existing loan assumptions would effectively be barred by S. 1703, 1720, and the administration. Individual lenders and brokers have responded to the needs of their markets by working out accommodations for individual customers on a case-by-case basis. These efforts represent the only practical means of financing home sales today. Actions to prohibit these transactions would force the average American home buyers to almost double their mortgage payment and preclude homeownership opportunities for an indefinite period of time.

Actions by the Federal Reserve Board that would bring virtually all forms of creative financing under truth-in-lending coverage, though not final, present yet another barrier to market responses to the current lack of available conventional mortgage credit.

We therefore concur with your decision, Mr. Chairman, to make it clear that such nontraditional forms of mortgage lending are not within the scope of truth in lending and its disclosure requirements.

Additionally, we look to the time when residential real estate transactions are entirely removed from the coverage of truth in lending.

The American view is clear that widespread homeownership insures democracy. This comes about by the fact that homeownership disperses decisionmaking to each individual household over the use and protections of the individual home. Each individual homeowner quite naturally has a stronger incentive to assure success and good conditions in the neighborhood, the community, town, or city.

Thus, the fact that two-thirds of the Nation's occupied housing units are owner occupied is a basic reason that democracy is more of a fact in the United States than elsewhere in the world. This view is not new and is the foundation on which national housing policies since the 1930's have been erected. This view was again documented in the recent national survey conducted during August 1981 by the Cambridge Surveys, Inc., and commissioned by the National Association of Realtors.

In that survey, 71 percent of all respondents agree with the statement that widespread homeownership insures greater democracy. Widespread agreement cuts across all regions, all age groups, and all income levels. These data, which confirm the importance in our national set of values of homeownership, underscore the profound importance of the current, prolonged, and continuing recession in housing.

In conclusion, Mr. Chairman, these hearings come amidst great economic turbulence. Your efforts to make depository institutions competitive in today's marketplace are commendable. However, we feel the proposals before the committee will tend to concentrate economic power in the hands of a few and will do nothing to solve the financing of the shelter needs of our Nation.

[The complete statement follows:]

Statement of the NATIONAL ASSOCIATION OF REALTORS®

Mr. Chairman - My name is John R. Wood. I am a REALTOR® from Naples, Florida and President of the NATIONAL ASSOCIATION OF REALTORS®. I appreciate this opportunity to appear before you today to present our concerns about the various proposals to restructure financial institutions.

In hearings reviewing the spectrum of issues surrounding our financial system held by this Committee last spring, we testified that it appeared our nation's commitment to a national housing goal seemed to be disappearing. Today, over 5 months later, amid numerous predictions that the homebuilding industry is fast approaching a severe depression and as home sales continue to plummet, we can only reiterate our grim assessment: That we are without a desperately needed cohesive housing policy, and indeed we may be without a market place that can provide residential financing.

Predictions aside, the figures speak clearly on the present state of housing. The 34 month old housing recession is not only the steepest but also the longest housing downturn since statistics have been gathered on the resale market.

The housing industry is currently suffering from the deepest recession in post-war history. Housing starts are at a 0.937 million units annual rate currently, and expected to average only 1.2 million units for 1981-virtually the same as last year. We expect only 1.5 million starts in 1982 and 1.5 million starts in 1983. Since the underlying demand for replacement and new housing is about 2 million units per year, housing supply is expected to continue far below the underlying housing demand. The implication is for housing to be in

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short supply throughout the 1980's as industry capacity will not be able to supply the growing needs of expected demographic demands and the leftover unsupplied demand of the current housing recession. This will only add to future increases in housing prices and rents, and will exert increased upward pressure on the long-term rate of inflation. Resale activity has also dropped from its November, 1978 peak of 4.02 million units to a low in August, 1981 of 2.26 million units.

The seriousness of the affordability crisis must not be missed. Large numbers of families are faced with the prospect of never owning their own home or never being able to move up the housing ladder.

This lost production and resales also means that nearly 5 million American families and workers have been unable to move. Relatively unrestricted mobility is of great value to our society and our economy since it allows families to better match their housing accommodation with current needs and enables workers to take advantage of job opportunities.

This decline in mobility means that there are currently numerous cases in which homeowners are mismatched with the housing they occupy. "Empty nesters" and others who occupy more housing than they currently need are unable to scale down their housing accommodations. At the same time, growing families who require more space must continue to occupy ill-suited quarters.

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Diminished mobility also creates a mismatch of workers with jobs and job opportunities. Employers are less willing to transfer workers because of the exceedingly high cost of relocation; and workers are less willing to seize new job opportunities. This reduced mobility greatly constrains our nation's ability to properly match workers and jobs and obtain much needed improvements in productivity.

With these distressing statistics seems to be a singular lack of interest on the part of the Administration and the Congress to propose solutions. The view that a return to a healthy economy with lower more stable interest rates will take care of housing's problems is reasonable, however, it assumes the existence of an industry capable of providing financing for the purchase of this housing. It also assumes that there will be homebuilders, lumber dealers, REALTORS®, and all those necessary participants, still in business, at the time of recovery. Unless relief comes in the next six months or so, the damage to the whole housing industry and the concomitant frustrations of millions of Americans seeking to buy a home may be so great that there could be harm brought upon the very fabric of this nation's being.

The American view is clear that widespread homeownership ensures democracy. This comes about by the fact that homeownership disperses decision-making to each individual household over the use and protections of the individual home. Each individual homeowner quite naturally has a stronger incentive to assure success and good conditions in the neighborhood, the community, town or city. Thus, the fact that two-thirds of the nation's occupied housing units are owner-occupied is a basic reason that democracy is more of a fact in the United States than elsewhere in the world. This view is not new and is the

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foundation on which national housing policies since the 1930's have been erected. This view was again documented in the recent national survey conducted during August, 1981, by the Cambridge Surveys, Inc. and commissioned by the NATIONAL ASSOCIATION OF REALTORS®. In that survey, 71 percent of all respondents agree with the statement that widespread homeownership ensures greater democracy. Widespread agreement cuts across all regions, all age groups, and all income levels. These data, which confirm the importance in our national set of values of homeownership, underscore the profound importance of the current, prolonged, and continuing recession in housing.

Mr. Chairman in your press conference on the day you introduced your legislation, S 1720 and S 1721, you speak of your frustration regarding the fact that government actions to address the problems confronting financial institutions have been piecemeal and haphazard. You correctly asserted that a comprehensive approach is much more desirable. However, we strongly feel that, for a variety of reasons, now is the worst time to proceed with comprehensive legislation that will affect financial industries and, in particular, the mortgage industry for quite some time to come.

After more than a decade of reviewing proposals for the restructuring of our nation's financial system the Congress, last year, enacted the most sweeping financial reform legislation since the Great Depression. With the passage of this ~~legislation--the~~ Depository Institutions Decontrol Act of 1980--thrift institutions are exploring greatly expanded lending authorities in an increasingly deregulated and economically hostile environment.

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The present dilemma of the thrifts is the need to attract funds by paying competitive rates while burdened with low-yielding portfolios of mortgages originated in the days of Regulation Q. In fact, approximately 60% of their liabilities are now paying market rates. As the DIDC moves to further increase the thrifts' cost of funds, through deregulation, the immediate financial viability of thrifts is in greater jeopardy. The chorus of protests from S & L executives is evidence of the precariousness of the thrifts as they struggle to comply with the program as outlined by the Congress in the Depository Institutions Deregulation Act of 1980. While the structure of the thrift industry is fast changing as a result of last year's Act, the fruits of these structural changes will take time before they appear. This fact was recognized by the Congress and accounts for the 6 year transition to a deregulated environment. Now, before anyone has had the chance to digest the major changes of last year, we are considering legislation that in effect could eliminate this nation's specialized home mortgage lending industry by forcing the survivors to become commercial banks.

Mr. Chairman, just as you are questioning yourself today as to how to make further budget cuts before the results are in of this year's budget reduction, so too are we and all other participants in the housing market questioning the action contemplated by this Committee. We strongly believe that once thrifts are able to bridge the transition period, they will be stronger and more viable than ever before.

To address this transitional crisis, a great number of actions have been taken in the last few months to improve the health of thrift institutions. The effects of these actions cannot now be ascertained. I am referring to

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several Federal Home Loan Bank Board regulatory actions, the commencement of the All Savers Program and other actions that will help the thrifts. I will briefly outline these actions.

The All Savers Certificate program enacted in the Economic Recovery Tax Act of 1981 began less than three weeks ago. This program will inject billions of dollars of below-market rate funds into thrift institutions at no little cost to the government. Surely this program will help troubled institutions through the rough economic waters ahead.

The Federal Home Loan Bank Board has implemented regulatory changes in accounting procedures for recording an institution's loss upon the sale of a low-yielding mortgage. The Bank Board's regulation will enable the loss to be recorded gradually over the life of the loan, mitigating problems on net worth requirements of having to record the entire loss at the time of sale.

In conjunction with this move, the two federally inspired secondary markets, FHLMC and FNMA have announced plans to take these low-yielding mortgages off the books of the institutions. FNMA has announced a program to purchase these mortgages outright and FHLMC has instituted a SWAP program whereby FHLMC exchanges Participation Certificates (with a slightly lower interest rate) for the mortgage in the lender's portfolio. The PC's provide the institution with greater flexibility and new business options.

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The FHLBB has also requested and received approval from the Federal Reserve Board for access to the discount window for thrift institutions. The discount window will provide an important tool as a lender of last resort to troubled institutions.

The Bank Board announced on September 14 a program for Income Capital Certificates. The certificates present a new option to the FSLIC as it attempts to help ailing institutions by way of "a kind of conditional IOU created by FSLIC lawyers", as they are described by the Wall Street Journal.

It is our feeling that these actions coupled with imaginative and effective actions by the federal regulators, perhaps with special "emergency" powers, will suffice to meet the transitional problems. In any case, as Chairman Volker has asserted major restructuring legislation is irrelevant in any discussion of the short-term problems.

Rushing to enact restructuring legislation that would dismantle this country's home mortgage finance industry before the effects of the actions I have just outlined are felt would be ill-advised and premature. Furthermore, recent actions and announcements would indicate that thrifts indeed can be profitable in the future as institutions primarily devoted to residential financing.

Mortgage lending has been given an important ticket to the future with the approval by all the federal regulators for lenders to make adjustable rate mortgage (ARM) loans. These ARM's will ensure that the crisis presently confronting the thrift industry will not repeat itself. Adjustments to mortgage

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rates to reflect changes in the lenders' costs of funds will ensure the thrifts of having viable portfolios. The fact that these adjustments can theoretically be made every 30 days means that thrifts will never again be caught by lending long and borrowing short.

This will not happen overnight, and, in fact, the federal regulators have in effect set broad parameters that gives great leeway to lenders to devise ARM instruments acceptable to the consuming public. We agree with the savings associations that ARM's, after an acceptable, standardized instrument is devised, will make future years profitable for S & L's. This fact was documented in testimony presented by the two savings and loan leagues before your Committee last May. To quote the National League:

"With this kind of flexibility (ARM), a savings and loan will be able in the future to continue to make mortgage loans without risking a recurrence of the current earnings problem. The liability side of our business has been substantially deregulated over the past two years. The adoption of this mortgage regulation begins a substantial deregulation of the assets side and makes us optimistic that if we can get through this economic transition period, we will have a viable mortgage finance system which balances the interests of both borrowers and savers. (Emphasis added)

Further developments and expansion of the secondary markets will also present more money-making mortgage options to thrifts. I am referring primarily to the use of conventional mortgage-backed securities to tap new

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sources of affordable capital for mortgage lending. At present, both FNMA and FHLMC are working to implement conventional mortgage-backed security programs, but it will take time for these instruments to be able to function adequately. S & L's will become more like today's mortgage bankers. They will make money by originating mortgages for sale to investors and by servicing these mortgages for the ultimate investors.

You see, Mr. Chairman, there is hope for specialized lending institutions primarily involved in residential financing, but, to release these institutions from the responsibility for home financing now, while the deregulation of last year ~~is incomplete~~ and unprecedented rates of interest are buffeting all sectors of our economy, would destroy hope for the future Americans who wish to find affordable financing to buy a home. The potential for social crises in the future would be great.

Beyond the recent actions I have briefly outlined as relief for thrift institutions are requests by federal regulators for powers to approve inter-industry and interstate mergers of institutions in danger of failing. The legislation introduced by the Chairman of this Committee has provisions similar to those in legislation recently passed by the House Banking Committee to address the short-term problem that may well arise should interest rates remain at current levels. While the NATIONAL ASSOCIATION OF REALTORS® has reservations about some of the broad implications of these actions, we believe the solvency of the insuring funds to protect depositors and this nation's financial stability to be paramount. In any case, actions by the regulators should be scrutinized to ascertain that emergencies indeed do exist.

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Competitive Implications of Deregulation

Mr. Chairman, there is another aspect of the issue of comprehensive financial reform which is of concern to the NATIONAL ASSOCIATION OF REALTORS®, and for that matter to every other representative of small business men and women. That aspect is the extent to which competition can survive such reform.

In our opinion the price which the proposals for financial reform now before this committee would exact would be a concentration of financial power which would make small business in credit sensitive industries, like real estate, truly America's Number 1 "endangered species."

When consideration is given to reforming the structure of financial institutions, such consideration necessarily involves the broadest and most critical implications not only for the survival of those institutions, but also for those businesses dependent on them. It is a truism that in a capitalist economy like ours the sine qua non of survival in the marketplace is access to credit and capital and financial institutions are the primary sources of such access.

It follows, therefore, that it is not enough to so structure financial institutions to survive. It is equally necessary that full, fair, and competitive access to those financial institutions survive. The present legislation in no respect assures the survival of such access.

There can be no questions but that the legislation under consideration will encourage, if not absolutely guarantee, a degree of merger and concentration of savings and loan and other thrift institutions such as has never before existed in the history of this country. In the past Congress has expressed, legislatively,

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its recognition of and concern for the competitive dangers and abuses of financial concentration in the banking industry. The Bank Merger Act of 1960 (74 Stat. 129 (1960), as amended 12 USCA 1828) and the Bank Merger Act of 1966 (1966) 80 Stat. 7, 12 USCA 1828) each have involved efforts to limit the merger of banks where the effect of such merger would substantially lessen competition, restrain trade, or tend to create a monopoly. Thus, Congress has mandated not only that bank mergers must be approved by one of three regulatory agencies, e.g. Comptroller of the Currency, the Federal Reserve Board, or the Federal Deposit Insurance Corporation, but are also subject to the competitive impact tests established by Section 1 of the Sherman Act and Section 7 of the Clayton Act.

We submit that if Congress undertakes to expand the powers of the thrift institutions it must, at the same time, as it has done with the banks, carefully define the limits of those powers and the extent to which they may be used anti-competitively. We find no such definition in the legislation before you.

It is impossible for the implications of this legislation to be considered independently of other policies which are under consideration by this administration and this Congress which will also define the extent to which control of sources of credit and capital may be used to short competition in the sale of goods and services.

These policies as they affect the real estate business, include but are by no means limited to:

a. The extent to which kickbacks and rebates to controlled businesses in the sale of real estate services will be legalized by Repeal of Section 8 of the Real Estate Settlement Procedures Act;

b. The extent to which acquisitions of financial institutions by giant suppliers of real estate services and conglomerates will be encouraged or countenanced by the Securities and Exchange Commission, the Federal Trade Commission, or the Antitrust Division of the Department of Justice;

c. The extent to which thrift and other financial institutions will be authorized to provide real estate services and products directly competitive to those who must rely on them for credit and capital.

The reason these policy issues are critical to the considerations of this Committee is manifest; control of the source of home financing by the source of housing services and products effectively limits, if it does not absolutely foreclose, competition in the market for such services and products. In today's market and for the foreseeable future control of the source of home financing effectively represents the power to dictate the broker to be employed, the title policy to be purchased, the escrow agent to be designated, the homeowners insurance policy to be purchased and even the stock broker or department store to be used. This means that there must be a separation of financial institutions from sources of real estate services if there are to be alternatives and competition in the marketplace. This means, too, that financial institutions must not be permitted to control consumer choice between those alternatives.

The concern of the small business men and women of the real estate business for their future and the future of freedom of consumer choice is real and legitimate. On the basis of the "entrance of huge, cash-rich companies"* such as Sears, Merrill Lynch, Control Data, American Invesco into real estate brokerage, predictions

*Chicago Tribune, Section 14, P. 1, "Real estate's 'big fish' -eing swallowed up, too", October 18, 1981

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are being made that 80 percent of the average 10 billion dollars in real estate commissions and fees will soon be shared by less than 10 organizations. Whether these predictions will come to pass depends, in large measure, on whether this Congress allows the reform of financial institutions to be the engine that drives the monopolization and oligopolization of the real estate business.

Mr. Chairman, we find nothing in this legislation which addresses this danger, let alone anything which removes it.

Due-on-Sale

Mr. Chairman, in the haste of considering comprehensive financial reform, this Association fears there is a real danger that the Congress may lose sight of some of the important functions of institutions which have been traditionally in housing markets. It would be tragic indeed if the Congress enacted legislation that would make it even more difficult in the future for American families to fulfill the American dream of purchasing a home. In particular, one specific action that would be extremely damaging to the housing market would be the enactment of a sweeping federal preemption of state laws that restrict enforcement of the so-called due-on-sale clause.

As you know, our position on the federal preemption is not founded on opposition to the due-on-sale clause itself. Our position seeks to promote accommodation through a blended rate of interest between contract and market rates. We firmly believe that due-on-sale can be made to work for the mutual benefit of all parties involved.

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This issue takes on even greater significance when one realizes that over the past year and a half it is estimated that approximately 50 percent of the 5.6 million resale transactions will involve the use of mortgage assumptions. In some areas of the country, the importance of assumptions is even greater. A recent study conducted by the California Association of REALTORS® documents that nearly 70% of resale transactions in California were predicated on the assumption of an existing mortgage. With institutional lenders either completely withdrawn from the market or offering interest rates in excess of 18 percent for adjustable rate mortgages, the benefits of assumption could not be more visible.

As you know, in some fourteen states, the legislatures and the courts have preserved the option of mortgage assumption by placing restrictions of full implementation of due-on-sale clauses. In the remaining 36 states accommodation of assumptions is going forward at interest rates negotiated between lenders and sellers. This accommodation, to permit assumptions at a negotiated interest rate, could well be threatened by a federal preemption of states rights. Such action would therefore destroy the only practical way of financing home sales today and would force the average American family to almost double their mortgage payment due to the increased interest rate.

While the National Association has not agreed with some actions adopted by the various states on this issue, we would hate to see a federal preemption wipe out state attempts to legislatively strike a balance between the problems of lenders and the needs of homebuyers. The importance of states rights alone warrants the defeat of efforts to federally preempt state laws regarding the enforcement of due-on-sale clauses.

ATION OF REALTORS® is comprised of more than
 REALTORS® located in every state of the
 Columbia, and Puerto Rico. Combined
 is nearly 700,000 persons actively
 management, counselling, and
 al, industrial, recreational
 es of the Association's
 real estate industry, such
 commercial and residential
 ment, construction and
 the largest membership
 ncerned with all facets

R. Wood, Naples, Florida;
 Houston, Texas;
 onna.

is Jack Carlson, Executive Vice

Government Affairs is Albert E.
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Reserve Board's decision that such "creative financing" activities are subject to the truth-in-lending disclosure requirements of Regulation Z. We do not believe it was the Congress' intention to regard these stop-gap financing techniques in their definition or understanding of "arranger of credit" and we concur with the Chairman's decision to exclude such activities from truth-in-lending coverage, as found in Section 703 of S. 1720. To the extent that such lending activities might become permanent fixtures in the future, there will be adequate evidence that its providers have become professional extenders of consumer credit in the clearest sense of that term.

In the meantime, the coverage of such activities in the broad and imprecise terms that are now found in Regulation Z is government regulation that is clearly unnecessary and unwarranted.

The Federal Reserve Board's difficulty in defining the acts and entities to be covered by the "arranger of credit" concept reveals a fundamental problem of truth-in-lending — the application of short term consumer credit criteria to long term real estate lending. Thus, the NATIONAL ASSOCIATION OF REALTORS® recommends, as it has many times in the past, the exclusion of residential real estate transactions from the Truth-in-Lending Act's coverage.

In conclusion, Mr. Chairman, these hearings come amidst great economic turbulence. Your efforts to make depository institutions competitive in today's marketplace are commendable. However, we feel the proposals before the Committee will tend to concentrate economic power in the hands of a few and will do nothing to address the shelter needs of our nation.

The NATIONAL ASSOCIATION OF REALTORS® is comprised of more than 1,806 local boards of REALTORS® located in every state of the Union, the District of Columbia, and Puerto Rico. Combined membership of these boards is nearly 700,000 persons actively engaged in sales, brokerage, management, counselling, and appraisal of residential, commercial, industrial, recreational and farm real estate. The activities of the Association's membership involve all aspects of the real estate industry, such as mortgage banking, home building, and commercial and residential real estate development, including development, construction and sales of condominiums. The Association has the largest membership of any association in the United States concerned with all facets of the real estate industry.

Elected Officers are: President John R. Wood, Naples, Florida;
President-elect Julio S. Laguarda, Houston, Texas;
Treasurer Budd Krones, Tucson, Arizona.

The Chief Administrative Officer is Jack Carlson, Executive Vice President and Chief Economist.

The Senior Vice President, Government Affairs is Albert E. Abrahams and the Vice President and Legislative Counsel, Government Affairs is Gil Thurm.

Headquarters of the Association are at 430 North Michigan Avenue, Chicago, Illinois 60611. The Washington Office is located at 777 14th Street, N.W., Washington, D.C. 20005. Telephone 202/383-1000.



The CHAIRMAN. Mr. Riedy.

Mr. RIEDY. My name is Mark Riedy. I'm executive vice president of the Mortgage Bankers Association of America, the trade association of the mortgage banking industry, whose interests cover the full range of real estate finance.

I am pleased to appear before you today to discuss S. 1703, the Thrift Industry Restructuring Act of 1981; S. 1720, the Financial Institutions Restructuring Act of 1981; and S. 1721, the Federal Deposit Insurance Consolidation Act of 1981.

MBA supports the general concept of deregulating financial institutions in order to assure their financial viability and achieve competitive equality in the public interest. We are concerned about the timing of and the management of the process of deregulation, however, particularly under the oppressive market conditions plaguing all financial institutions—depository as well as nondepository lenders—in today's economic environment.

We would also urge that caution be exercised in the deregulation process to insure that no one group of intermediaries is either favored or disadvantaged through congressionally enacted statutes or administratively determined regulations.

One concern that has been raised with respect to S. 1703 and S. 1720 is the effect of the enactment of this legislation on the future cost and availability of residential mortgage finance in this country. If restructuring creates shortfalls in the availability of residential mortgage finance, the emergence of the secondary mortgage market as a critically important source of mortgage credit will be accelerated and the significance of MBA's proposals will be, I think, reinforced.

Indeed, irrespective of the effects of deregulation on depository institutions, it is our belief that the growth and evolution of the secondary mortgage market, supported by the strengthening of two of the three major federally related institutions in the secondary market, Fannie Mae and Freddie Mac—promise an amply supply of residential mortgage credit in the years ahead.

ELIMINATION OF GNMA

There is a potentially damaging offset to this promising outlook, however. Reports we have heard indicate that the administration is leaning toward the reduction and eventual elimination of the GNMA-guaranteed mortgage-backed security program.

The GNMA-MBS is the foundation of the modern secondary mortgage market and has served as the primary vehicle and prototype for other securities through which lenders have successfully tapped nontraditional sources of residential mortgage financing.

Ironically, the administration's reported plan unilaterally to reduce the GNMA-MBS activity ceiling by as much as 25 percent from the levels recently approved by the Congress will not have an immediate damaging effect. Rather, if interest rates continue their recent welcome decline into next year, the housing recovery that the economy normally could rely upon to help lead us out of recession will be aborted prematurely, at least for the moderate income housing sector that relies importantly on the FHA-insured and VA-guaranteed home loans sold through GNMA pools, when the reduced GNMA ceilings are reached.

In a similar vein, for the Nation's secondary mortgage market to reach its full potential, State-imposed restrictions on adjustable rate mortgages, ARMS, and the enforcement of due-on-sale clauses must be removed. MBA supports part C of title I of S. 1720, which will preempt State due-on-sale restrictions for all lenders.

We would also urge the committee to consider a similar preemption of State laws that restrict the ability of HUD-approved mortgagees and State-chartered, federally insured depository institutions to originate the same types of ARMS approved for federally chartered lenders. Suggested legislative language for such a preemption is contained in appendix 3 of MBA's formal statement.

The permanent removal of the volume limit on purchases of "old" loans by Fannie Mae and Freddie Mac, as contained in section 173 of S. 1720, could also substantially hinder the capacity of the secondary market to meet the mortgage credit needs of current and prospective homebuyers. The permanent removal of these volume limits would represent a fundamental shift in the role of these institutions in the secondary market, a shift that should not be allowed to take place almost accidentally, without extensive discussion of its potential costs and benefits.

Moreover, we are concerned that the conversion of these old mortgage loans into highly marketable mortgage-backed securities could prompt a massive sale of these securities when interest rates moderate. Upward pressure on mortgage interest rates could result prematurely, stifling a recovery in badly needed residential construction.

Rather than a permanent removal of the volume limitations, we suggest a 1-year waiver. In this way the Congress can reexamine the effects of the program after a reasonable trial period to determine if the waiver should be continued. Suggested legislative language is continued in appendix 4 of our testimony.

One critical ingredient for the future success of the secondary mortgage market is enactment of the FHLMC capitalization bill, and MBA urges prompt and favorable consideration by the committee when that bill is introduced. The proposed legislation will enable FHLMC to expand vastly the volume of conventional mortgages loans of FHLMC guaranteed MBS'. The CMBS programs being proposed by both FHLMC and FNMA are patterned closely after the GNMA MBS, further illustrating the crucial secondary market role played by the GNMA program.

In closing, I would like to highlight several concerns of MBA with respect to S. 1720. First, we urge the committee to grant equal real estate lending authority to thrift institutions and commercial banks in any legislation that is reported.

Second, MBA believes that restrictions on insurance activities of bank holding companies as contained in title VI would diminish competition in the sale of insurance and is at odds with the spirit of deregulation that permeates S. 1720. We oppose such restrictions.

Next we believe that the proposed amendments to the Truth-in-Lending Act point out the need for a more basic change in the law. Loans secured by the mortgages on real estate should be excluded from the act.

Last, MBA supports title IV which would preempt State usury laws for consumer lending. I would be happy to answer any questions later.

[Complete statement follows:]

STATEMENT OF
DR. MARK J. RIEDY
EXECUTIVE VICE PRESIDENT
of the
MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. Chairman and members of the Committee, my name is Mark J. Riedy and I am Executive Vice President of the Mortgage Bankers Association of America.* MBA is the trade association of the Nation's mortgage banking industry. Accompanying me are Burton Wood, MBA's Legislative Counsel, and Glen Corso, Deputy Legislative Counsel.

I am pleased to appear before you today to discuss S 1703, The Thrift Industry Restructuring Act of 1981, S 1720, The Financial Institutions Restructuring and Services Act of 1981, and S 1721, The Federal Deposit Insurance Consolidation Act of 1981. My testimony today will concentrate on several points. The first is the future course of residential mortgage finance in the context of the proposed deregulation and expansion of lending powers for all depository institutions, but especially thrift institutions, inherent in S 1703 and S 1720. Second is the proposed preemption of state due-on-sale restrictions in S 1703 and S 1720 and MBA's urging of a similar preemption covering non-federally chartered lenders with respect to adjustable rate mortgages (ARMs). The third point is the proposed removal of the volume limitation on the number of loans one year old or older that can be

*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership is comprised of mortgage originators, mortgage investors, and a variety of industry related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- o Mortgage Banking Companies
- o Mortgage Insurance Companies
- o Life Insurance Companies
- o Commercial Banks
- o Mutual Savings Banks
- o Savings and Loan Associations
- o Pension Funds
- o Mortgage Brokers
- o Title Companies
- o State Housing Agencies
- o Investment Bankers
- o Real Estate Investment Trusts

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purchased by the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA). Lastly, the testimony will discuss the amendments to the Truth-in-Lending Act, the amendments to the Bank Holding Company Act relating to insurance sales by bank holding companies, and the proposed preemption of state usury laws relating to consumer lending.

DEREGULATION

Before dealing with our specific areas of concern with respect to S 1703, S 1720, and S 1721, we would like to say that MBA supports the general concept of deregulating financial intermediaries, such as thrift institutions and commercial banks, so as to allow the free flow of capital through the market forces of supply and demand. We believe that concept is present in some of the provisions of S 1703 and S 1720. However, a vital corollary to that concept is the principle of equal treatment of financial intermediaries by the Federal government. We do not believe that one group of intermediaries should be favored or disadvantaged through Congressionally enacted statutes or administratively imposed regulations. We urge this Committee, and the entire Congress, to keep the deregulation concept and the principle of equal treatment in mind as work proceeds on S 1703, S 1720, S 1721, and any related legislation.

MORTGAGE FINANCE

A concern that has been raised with respect to S 1703 and S 1720 is what effect the enactment of such legislation will have on residential mortgage finance in the future. It is our belief that the growth and evolution of the secondary mortgage market, together with changes that are taking place in two of the three major federally related institutions in the secondary market—FNMA and the FHLMC—should assure an ample supply of

mortgage credit to meet America's future housing needs. This growth and evolution should mean that mortgage lenders will be able to meet the residential mortgage finance needs of their communities by originating loans for sale in the secondary mortgage market, rather than retaining those loans in their own investment portfolios. Thus, even with an expansion of lending powers, depository institutions will still be able to be extremely active residential mortgage originators and America's housing needs will not go unfulfilled.

However, this scenario is vitally dependent on the outcome of several events that either are taking place, or could take place, that involve Congress and the Federal government. Foremost among those is the fate of the Government National Mortgage Association (GNMA)-Mortgage-Backed Security (MBS) program. Reports we have received indicate that the Reagan Administration is moving toward an elimination of this user-fee supported program that has blazed the way for residential mortgage finance to attract capital from non-traditional mortgage investors. This achievement is the foundation for the modern secondary mortgage market. It has served as the model for the manner in which lenders can continue to match the needs of homebuyers for residential financing with investor requirements.

A second event necessary to fulfill the potential of the secondary market is the removal of state-imposed restrictions on ARMs and exercise of due-on-sale clauses. We support Part C of Title I of S 1720, which will preempt state due-on-sale restrictions for all lenders, as absolutely vital to remove a growing hinderance to an effective and truly national secondary mortgage market.

We urge the Committee to consider a similar preemption of state laws that restrict the ability of all lenders to offer the types of ARMs authorized for federally chartered

lenders. Suggested legislative language for such a preemption is contained in Appendix 3 of this statement.

An event that could substantially hinder the ability of the secondary market to meet the mortgage credit needs of current and prospective homebuyers would be the permanent removal of the volume limit on old loan purchases by FNMA and FHLMC as contained in Section 173 of S 1720. We are extremely concerned that the conversion of these old mortgage loans into highly liquid mortgage-backed securities, coupled with proposed changes to the accounting rules for losses for thrift institutions, could prompt a massive sale of the certificates when interest rates moderate. A flood of these certificates into the market at such a time could force mortgage interest rates upward prematurely.

Rather than a permanent removal of the volume limitation, we suggest a one-year waiver. In this way, Congress can reexamine the effects of the program after a one year period to determine if it should continue. Suggested legislative language for such a waiver is contained in Appendix 4 of our testimony.

Lastly an event whose occurrence is vital to the success of the secondary market in meeting America's residential finance needs is enactment of the FHLMC capitalization bill. This proposed legislation will enable the FHLMC to expand vastly the volume of conventional mortgage loans that can be sold into the secondary market. It will do so by authorizing the FHLMC to guarantee conventional mortgage-backed securities (CMBSs) issued by lenders, similar to the role played by GNMA for securities backed by Federal Housing Administration (FHA) and Veterans Administration (VA) mortgages. The FHLMC capitalization bill will vastly expand the potential sources of capital for mortgage finance and enable lenders to attract non-traditional investors.

Nationally, housing and mortgage markets are currently in extreme depression and disarray. However, we believe that the outcome of the events sketched above, and explained in greater detail later in this statement, will potentially have a more significant impact on residential mortgage finance than will the enactment of S 1720 or similar legislation.

Current State of the Housing Market

The housing market is currently in what most accurately must be described as a depressed state. The efforts of the Federal Reserve Board to reduce inflation through slow monetary growth is the major cause of the depressed state of the housing industry. High financing costs for home builders and potential buyers should keep 1981 housing starts below 1980 levels, perhaps as low as 1.1 million total starts, the lowest volume in at least 20 years. Of this number, approximately 300,000 will be multi-family starts, mostly condominiums. New residential construction in 1982 will be only slightly better, with starts for the year optimistically forecast at between 1.4 and 1.6 million units. Between 300,000 to 400,000 of the 1982 starts will be multi-family, again predominantly condominiums. In the resale market, the problems are even more apparent. August existing home sales were at a 2.26 million unit annual rate, down 10 percent from last year's depressed sales and more than 40 percent below the levels of 1979. New home sales in August were at their lowest level since April 1980 and the third lowest monthly rate since the government began collecting these statistics in 1963.

Clearly, the depressed level of housing construction of the past two years has been a disaster for the construction industry. What is not yet well known, though it is now beginning to surface, is the tremendous difficulty being experienced by construction lenders, whose inventories of non-accruing loans and foreclosures are mushrooming as builders increasingly find it impossible to pay high interest costs for long periods when

new homes sit vacant on the "for sale" market. Further, the housing depression also represents a disaster for the consumer. Most estimates of population and household formation rates envision the decade of the 1980s as one of sustained extremely strong housing demand. While the general population will increase by 21 million people in the next decade, the population of the prime first-time home buying group, those between 25 and 34 years, will grow by nine million persons by 1990. This is a level three times faster than overall population growth. Many analysts foresee a new housing demand averaging approximately 2.2 million housing starts per year for the next decade. Clearly, 1981's 1.1 million starts will be far below the equilibrium level. Even more importantly, however, 1982's optimistically projected 1.4-1.6 million starts will also fall far short of expected demand. This fact is even more apparent when a comparison is made with the starts levels of the last half of the 1970s, when demand was also high.

Year	Private Housing Starts (seasonally adjusted annual rate)
1976	1,537,000
1977	1,987,000
1978	2,020,000
1979	1,745,000
1980	1,292,000

Source: Department of Commerce, Bureau of the Census

Some of the shortfall in supply will be made up in part with conversion of commercial properties into residential use. However, the shortage of housing in the face of exceptionally strong potential demand will cause a significant increase in "doubling up," an increase in the upward spiral of home prices, and continued conversion of rental units to satisfy ownership demands. In effect, the American homebuyer no longer has a reasonable

choice among affordable housing options, and, indeed, may not be able to afford desirable housing at all.

Even as the groundwork is being laid for future home price increases, current conditions are forcing a slowing, and in some areas, a decline of price levels. As high interest rates keep sales at suppressed levels, creative financing techniques have sprung up. The lower interest rates and seller "take-back" features of many of those arrangements are often not reflected in the sales price of the dwelling, but they nonetheless have the effect of reducing the real cost of housing. This trend is a temporary expedient, and will be reversed in the future as demand is translated into sales with a limited supply of houses available. While the real reduction in sales prices through creative financing techniques may be welcome relief from the inflationary spiral in housing, their new financing techniques are potentially destabilizing influences for the mortgage market in coming years.

Future Sources of Mortgage Credit

The year 1980 marked an historical culmination in a phase of growth and evolution in the secondary mortgage market that began in the late 1960's. In 1980, for the first time, mortgage loans sold in the Nation's secondary mortgage market equalled approximately 50 percent of all residential mortgage loans that were originated during the year. The decade-long average of originations versus sales was approximately 33 percent, with the yearly percentage increasing to the high 30's and 40's in the last two years of the decade.

The historical culmination that was reached was due to the success of the Federal government's intervention in the secondary mortgage market, which began with the creation of FNMA as a private corporation in 1968, the creation of GNMA, most particularly the GNMA-MBS program in 1968, and the creation of the FHLMC in 1970.

These three institutions dominated the secondary mortgage market in the 1970s. FNMA has a loan portfolio of approximately \$58 billion, while GNMA has guaranteed some \$120 billion of MBSs, backed by FHA-insured loans and VA-guaranteed loans. The FHLMC has purchased approximately \$25 billion in mortgage loans and issued well over \$20 billion in mortgage participation certificates.

Despite these impressive figures and the significant fact that loans sold last year equalled about half of all loans originated, the future growth and financial vitality of the secondary market and its ability to supply mortgage credit needs independent of portfolio lenders, hinges on the outcome of several events.

Reductions in GNMA Activity Ceilings

While the purchase activity of both FNMA and FHLMC has been extremely impressive it does not match the tremendous success of the GNMA-MBS program. The highly liquid GNMA-MBS forms the backbone of the nationwide secondary mortgage market. The GNMA-MBS program has demonstrated that mortgages can compete with corporate and other debt securities in the capital market provided they can be packaged in a fully guaranteed security form. GNMA-MBSs are backed by pools of FHA-VA mortgages that are formed by private lenders using these private funds. These lenders issue GNMA-MBSs that are guaranteed by GNMA and represent an undivided interest in the pool of FHA-VA mortgages backing the MBS.

This transformation of a group of home mortgage loans into a form resembling a corporate or government security enables lenders to go well beyond the circle of traditional mortgage investors to attract capital for residential finance. A major reason is that investment in a GNMA-MBS does not require any specialized knowledge of real estate

finance. The lender who issues the GNMA-MBS pledges to make monthly payments to the investor regardless of whether each and every homeowner whose mortgage is in the pool makes their monthly payments. And the lender's pledge is backed by GNMA's guarantee for which GNMA charges the lender a fee. Those fees are deposited in a fund from which any claims against GNMA by investors are paid.

The success of the GNMA-MBS program has encouraged both FNMA and FHLMC to propose guaranteed-CMBS programs of their own in order to increase both their volume and profitability and also to tap additional capital sources for mortgage loans.

Yet at the same time that the GNMA-MBS has achieved the distinction of being an eminently successful and user-fee supported Federal government program, the Administration is reportedly seeking to phase the program out by imposing artificially low activity ceilings on this demand-oriented program. Ironically, the reported Administration proposal to reduce unilaterally the GNMA-MBS activity ceiling by approximately 25 percent will have a real rather than illusory effect only if the housing industry begins its recovery from depression next year. Then the restrictive GNMA limit will hamper the housing recovery by choking off an important source of mortgage credit when GNMA issuers are forced to curtail their activities as the ceiling is reached.

In the Department of Housing and Urban Development (HUD)-Independent Agencies appropriation bill (HR 4034) the Congressional Conference Committee set the activity ceiling for the GNMA-MBS program at \$68.25 billion. Reports received by MBA indicate that the Administration, without seeking Congressional approval, will impose a \$50 billion ceiling on the program. This limit, our reports indicate, may be a prelude to a phaseout of the program in FY 1983 or FY 1984. Such a phaseout will have a direct and devastating impact on the FHA single-family mortgage insurance programs and the VA-guaranteed

loan program because the bulk of FHA and VA loans that are originated are sold as part of GNMA-MBS pools.

Additionally, the phaseout of the GNMA program will have a sharply detrimental effect on the secondary mortgage market. The GNMA-MBS serves as the most valuable link between the secondary mortgage market and the Nation's capital markets. No substitute currently exists. If the FNMA and FHLMC-CMBS proposals go forward then perhaps in three to five years the need for the GNMA-MBS would diminish, but not now.

The GNMA-MBS has operated very well as an instrument that enables lenders to match the needs of homebuyers for financing with investor requirements.

The presence of GNMA-MBSs has also served as a vital counter-cyclical tool for the housing and mortgage finance industries, and thus has helped to stabilize the mortgage credit cycle at times when traditional portfolio lenders were unable to do so. During the credit crunch of 1973-74, and again in 1979-80, the GNMA-MBS permitted FHA and VA lenders to offer mortgage credit to moderate-income homebuyers at times when thrift institutions and commercial banks, due to negative savings flows and high interest rates, were forced to curtail sharply their lending activities. This countercyclicality will be lost with a premature phaseout of the GNMA-MBS program.

Preemption of State Laws

MBA supports Part C of Title I of S 1720 dealing with the preemption of state due-on-sale restrictions. Currently, federally chartered savings and loan associations enjoy a preemption from state laws that restrict or prohibit the exercise of due-on-sale clauses in mortgages by virtue of regulations issued by the Federal Home Loan Bank Board (FHLBB).

National banks will also enjoy such a preemption if proposed regulations issued by the Comptroller of the Currency are finalized. Part C of Title I would extend equal treatment to all mortgage lenders, including mortgagees approved by the Department of Housing and Urban Development (HUD).

We also urge this Committee to consider a similar preemption of those state laws that restrict or prohibit HUD-approved mortgagees and state-chartered, federally insured depository institutions from offering the same types of ARMs that federally chartered lenders are able to offer (see Appendix 1). Federally chartered lenders enjoy a preemption from state laws that otherwise would prohibit or restrict them from offering the full range of ARMs made available through regulations issued by the FHLBB and the Comptroller of the Currency.

In order to avoid the detrimental and potentially severe effects on the availability of funds for home mortgages that these state laws could have, MBA recommends consideration of inclusion of a Federal preemption in § 1720 similar to the legislative proposal drafted by MBA contained in Appendix 3. The MBA-proposed preemption would preempt state laws that prohibit or restrict HUD-approved mortgagees and state-chartered, federally insured depository institutions from originating the same types of ARMs approved for federally chartered lenders.

The effect of these state laws that restrict both ARMs and exercise of due-on-sale clauses is pervasive. HUD-approved mortgagees, and state-chartered, federally insured depository institutions in some 23 states will not be able to offer the ARMs available from federally chartered lenders. As for due-on-sale, there are restrictive or prohibitive laws in 14 states that affect the two groups of lenders listed above (see Appendix 2).

The state law restrictions and prohibitions on exercise of due-on-sale clauses have already disrupted the secondary mortgage market. The two major institutional investors, FHLMC and FNMA, have altered their investment practices and procedures respecting loans originated in those 14 states listed in Appendix 2. FNMA requires a seven-year "call provision" to be inserted in mortgages originated in those 14 states. For a period, FHLMC did not accept loans from states where the restrictions on due-on-sale were so severe that lenders could not even examine the creditworthiness of a third-party assumptor. These actions mark a significant, adverse change in the nationwide character of the secondary mortgage market and will seriously impact interstate commerce.

The disruption of the mortgage market caused by restrictions on the enforcement of due-on-sale clauses is demonstrated dramatically in the portion of the market served by FNMA. As mentioned earlier, FNMA requires a seven-year call provision in conventional mortgages from states with such restrictions. However, for mortgages originated by federally chartered savings and loan associations that have the protection of the FHLBB preemption, this requirement is waived. The result is that two lenders, with offices side-by-side on Main Street, both originating mortgages for sale to FNMA, and both competing for commitments in the same FNMA auction, cannot both offer prospective home buyers the same terms. The competitive inequity in such situations is obvious and works to the detriment of all potential home purchasers.

The same sort of side-by-side inequity will soon occur among lenders offering ARMs. Those favored with a preemption from state law will be able to offer the full panoply of ARMs, thus offering consumers the broadest possible choice. Those without a preemption will not. Competition will be reduced and, ultimately, consumers will be the losers.

As stated earlier, in order for lenders to accommodate consumer demand for mortgage credit, a vibrant, active, nationwide secondary mortgage market is essential. In order to have such a secondary mortgage market, there must be full and free competition among lenders to produce mortgages that serve the needs of home buyers and are attractive to investors. State laws that limit the number of lenders that can offer ARMs or mortgages with due-on-sale clauses have the opposite effect to what is needed for a strong, vibrant, and nationwide secondary mortgage market.

MBA has drafted a proposed preemption (see Appendix 3), that would remedy this inequity by allowing all lenders to offer the same array of mortgage loans. Quite simply, the proposed legislation would preempt state laws that have failed to respond flexibly to the rapid evolution in the nature of residential mortgage markets in recent years. It would enable HUD-approved mortgagees, and state-chartered, federally insured depository institutions to offer ARMs that conform to regulations issued either by the Federal Home Loan Bank Board or the Comptroller of the Currency, irrespective of any prohibitive or restrictive state laws.

Lenders would be competing on equal terms for mortgage business and consumers would benefit both by having a choice of lenders and a broader array of terms and instruments to choose from. We urge your favorable consideration of this legislation or something similar as a means of helping to ensure that America's home financing needs will be met.

Removal Of Old Loan Limit

MBA is concerned about Section 173 of S 1720 that would remove the current limit on the number of loans one year or older that can be purchased by both FHLMC and FNMA. The current limit is equal to 20 percent of the aggregate cumulative balance of all

conventional loans they have purchased. We recognize the necessity of lifting the current limitation in order to permit the operation of the programs that FHLMC and FNMA are carrying out, which will permit lenders to swap their old mortgage loans for mortgage-backed securities bearing the same maturity and interest rate as the loans being exchanged less the fee paid to FNMA or the FHLMC.

We realize that these programs are aimed at providing depository institutions, especially thrifts, greater flexibility in the use of their existing portfolios of mortgage loans, most of which carry interest rates well below current market rates. We also realize that these programs are designed to meet the current, and hopefully temporary, extreme situation in which many depository lenders find themselves, and that the need for this program is expected to diminish as the interest rate situation improves.

There are two aspects of Section 173 that are particularly troublesome, however. First, it represents a fundamental shift in the role of FNMA and the FHLMC. These institutions were created by Congress to provide a secondary market for newly originated mortgages, thereby increasing the liquidity of the mortgage markets, and helping to ensure ample supplies of mortgage credit for home buyers. Section 173 will do none of those things. It is designed to ease the financial difficulties of depository lenders. Secondly, while the proposed section is needed to permit FNMA and FHLMC to meet a temporary situation, the remedy is a permanent one. In the future, when the need for these programs diminishes, there will continue to be no limit on the amount of old loans that FHLMC and FNMA can purchase. In and of itself this might not be so troubling. However, we foresee a scenario where the very conditions that should diminish the need for the program—a drop in interest rates—could serve to increase the popularity of the program because the losses that lenders would have to accept on the sale of these securities would be less and they would be encouraged to swap even more of their old loans in order to sell them more

easily. Thus, programs designed to be temporary expedients could become permanent fixtures.

In addition, the sale of these securities backed by old loans would be in direct competition with securities backed by new mortgages. The situation could arise where the interest rates required for new mortgage loans would be higher than it otherwise would be, because of securities backed by old loans flooding into the secondary market, just as interest rates start to decline.

In examining the question of how great a shift in the role of FNMA and FHLMC the provisions of Section 173 represent, it is instructive to examine the legislative history surrounding the original provisions governing the purchase of old loans. The provisions that Section 173 would excise were enacted into law as part of the Emergency Home Finance Act of 1970 (PL 91-351), which created FHLMC and granted FNMA authority to purchase conventional loans. PL 91-351 limited the purchase of old loans to 10 percent of the cumulative aggregate of all conventional loans purchased by the two entities. The House and Senate Committee reports (page 9 of both H Rept 91-1131 and S Rept 91-761) on PL 91-351 stated that the limitation was to "... assure that the bulk of the purchases would make funds available for additional housing ..." (emphasis supplied).

In the Housing and Community Development Act of 1974 (PL 93-383), the 10 percent volume limit was increased to 20 percent. This figure was the result of a compromise between the House, which had no provision in its bill, and the Senate, which proposed lifting the limit entirely but requiring sellers of old loans to warrant that they would invest the proceeds in new mortgages within 180 days of the sale. The Conference Report on PL 93-383 was silent on the reason for the compromise provisions. However, the Senate Committee report (Rept 93-693) explained that the provision to lift the limit and

require reinvestment in mortgages within 180 days was to allow smaller savings and loan associations an opportunity to raise funds to invest in mortgages when they are unable to raise sufficient funds to do so from savings deposits.

Clearly, the limitation contained in current law was designed to focus FNMA's and FHLMC's activity on the purchase of newly originated mortgage loans. This focus was to ensure that FHLMC's and FNMA's purchase activities assisted the housing and mortgage finance needs of home buyers by providing liquidity to the secondary mortgage market.

The provisions of Section 173 however, do the exact opposite. No additional mortgage money will necessarily be created, nor is there imposed a requirement to reinvest the funds realized from the sale of these mortgage-backed securities into new mortgages. Instead, FNMA and FHLMC will expend their limited precious capital and greatly expand their outstanding debt by issuing or guaranteeing mortgage-backed securities that are backed by old mortgage loans rather than newly originated loans. And, the sale of these securities in quantity could actually cause the interest rates on newly originated mortgage loans to be a level higher than necessary. In this respect, it is instructive to note that Congress, in enacting the Economic Recovery Tax Act of 1981 (PL 97-34) in August required financial institutions to place 75 percent of the proceeds from the sale of the one year, tax-exempt savings certificates in housing related investments.

We urge the Committee to scrutinize closely Section 173 with the understanding that its enactment would signify a fundamental shift in the role of FNMA and FHLMC in home mortgage finance. Additionally, we urge this Committee not to create a permanent change in the law to meet a temporary situation, but rather to provide a one-year waiver of the 20-percent limitation for both FNMA and FHLMC. In this way, there can be a reexamination of these provisions at a definite point in the future so that Congress can

determine if the benefits of the waiver have outweighed the costs to those seeking mortgage finances.

Suggested statutory language for the suggested one year waiver of the volume limitation on the purchase of old loans is included in Appendix 4. Essentially, we propose that a provision be inserted in the FHLMC and FNMA Charter Acts that would provide that all loans one year old or older purchased during a specified twelve month period would not be considered loans one year old or older for purposes of the 20 percent volume limitation. In this way, both FNMA and FHLMC could run their swap programs at a level chosen by them for the twelve month period in order to meet the needs of portfolio lenders seeking additional liquidity. Toward the end of that period, if Congress determines that conditions still merit continuation of the swap programs at the volume levels chosen by FNMA and the FHLMC, then Congress could amend the waiver and lengthen the applicable time period.

In this way the swap programs will be temporary expedients and not permanent fixtures. The provisions will not permanently alter the nature of FHLMC and FNMA, and any adverse effect on the secondary mortgage markets will be limited.

FHLMC Capitalization Proposal

FHLMC will soon present a draft bill for introduction in Congress that would authorize the restructuring of the FHLMC in order to attract additional capital for an expansion of its mortgage activities. MBA endorses the capitalization plan of the FHLMC as a step necessary to broaden the capacity of the secondary mortgage market, as explained previously.

The proposed legislation will transform the FHLMC into a government chartered, privately owned corporation authorized to purchase mortgages, to issue CMBS, and to guarantee CMBSs issued by eligible sellers. The legislation would permit the FHLMC to guarantee CMBSs issued by FHLMC-eligible sellers and backed by pools of mortgages, patterning its plans on the successful operations of the GNMA-MBS pools of government insured and guaranteed loans. The stunning success of the GNMA-MBS, in large part due to its liquidity and attractiveness to a wide range of non-traditional mortgage investors, has created the impetus for the FHLMC's proposal to recapitalize and initiate a program to guarantee CMBSs. Once this program is operational, the ability of the secondary mortgage market to supply the capital needed for America's mortgage credit needs will be enhanced.

MBA would like to comment specifically on one aspect of the FHLMC proposal. In order for the capitalization proposal to provide the necessary expansion of secondary mortgage investment sources, it is mandatory that all individual sellers and servicers be treated in a non-discriminatory manner. The FHLMC, in setting its purchase and ownership requirements, as well as fees and charges imposed, should not be permitted to differentiate between different types, or classes of sellers and servicers. It may be necessary and should be permissible for the FHLMC to differentiate between individual sellers and servicers for valid reasons, e.g., assets, size, etc. Non-discriminatory treatment of all mortgage sellers and servicers will ensure the broadest possible participation and prevent the domination of the FHLMC-CMBS program by any particular type or class of institution that might attempt to shift the program to its own individualized advantage.

Without further exploring the details of FHLMC's proposed legislation, MBA would like to stress the importance of expanding the capacity of the secondary mortgage markets, especially in light of legislative proposals to broaden the powers of banks and thrift

institutions. The turbulence being experienced in today's mortgage finance markets will be exacerbated unless the necessary steps are taken to enable the major secondary mortgage market entities to provide the necessary capital.

Traditional banking functions and powers will undoubtedly continue to be revolutionized. This transformation, however, will be incomplete unless thorough consideration is given to the question of where adequate sources of capital for mortgage finance can be secured. MBA believes that the FHLMC proposal for its capitalization serves as a vital link if the transformation is to be a successful improvement.

RELATED PROVISIONS OF 1720

MBA also has concerns regarding several other provisions of S 1720. Among these are: Section 203, which would amend current restrictions on the real estate lending powers of national banks; Title VI, dealing with the insurance activities of bank holding company subsidiaries; Sections 703-706 which would amend the Truth-in-Lending Act; and Title IV, which would preempt state usury laws with respect to consumer lending.

Bank Real Estate Lending Powers

The stated purpose of Section 203 of S 1720 is to simplify the statutory framework by which national banks are authorized to engage in real estate lending activities. Without commenting on the merits of Section 203's provisions, we would point out that the restrictions that would be imposed by Section 203 are less flexible than those that would be imposed on thrift institutions by Section 122. In the interests of the principle of equal treatment for financial intermediaries we enunciated earlier, we recommend that the

Committee draft identical restrictions on real estate lending for thrift institutions and commercial banks.

Similarly we note that Section 130(4)(b) of S1720 would authorize savings and loan associations to invest up to 5 percent of their assets in service corporations. These service corporations can engage in joint real estate ventures and other forms of equity participations, and, as such, present growing competition to mortgage banking companies that are subsidiaries of commercial banks. We urge the Committee to consider the fact that commercial banks do not have a similar means for offering equity financing, and thus are at a competitive disadvantage in meeting the demand for equity financing present in today's real estate lending environment.

Property, Casualty, and Life Insurance Activities of Bank Holding Companies

Title VI of S 1720 would prohibit subsidiaries of bank holding companies from selling property, casualty, and life insurance, except under limited circumstances. MBA respectfully opposes adoption of this prohibition. MBA is opposed to any legislation that would limit subsidiaries of bank holding companies, including mortgage banking companies, from engaging in the property and casualty insurance business.

Many mortgage banking companies sell property and casualty insurance. Some of these companies are subsidiaries of bank holding companies, and some are independent. They are in the insurance business because property and casualty insurance is related to their real estate financing activity. A mortgage banker's security for a loan is the real estate that is subject to the mortgage. In order to protect that security, lenders insist that borrowers obtain adequate property and casualty insurance. It is a perfectly natural and logical extension of a mortgage lender's business to offer this kind of insurance to its borrowers.

This natural link might suggest that the insurance activity of MBA members is limited to policies sold to borrowers. This is not so. In many companies the proportion of policies sold to non-borrowers exceeds that of borrowers from the company.

MBA recognizes that its bank holding company members now selling insurance would be protected to a significant degree by exception "D" of Section 601 of S 1720, the so-called "grandfather" clause. This relief is certainly important and should be included in any restrictive legislation that might be adopted. But the exception does not completely free existing operations from restrictions because they will be prohibited from extending their insurance activity into new states they may enter as lenders. The mortgage lending business is expanding geographically as mortgage banking firms enter new markets. The "grandfathered" bank holding company insurance agencies at least should be allowed to conduct insurance operations in any state in which their bank holding company is engaged in real estate financing.

MBA also recognizes that the first exception "A" contained in Section 601 would allow the continued sale of credit life and credit disability insurance by subsidiaries of bank holding companies. Even more than casualty and property insurance, these are related to the function of lending because all types of borrowers can benefit from such protection. To allow this activity to continue is in the public interest.

The other four exemptions are more narrow in their impact. They would allow finance companies to sell insurance covering damage to loan collateral; permit bank holding companies to sell insurance in places that have a population not exceeding 5,000, or that have inadequate insurance agency activity; exempt holding companies that have assets of \$50 million or less; and permit bank holding companies to supervise on behalf of insurance underwriters the activities of retail insurance agents selling certain types of insurance.

To the extent they free portions of the market from unnecessary control, MBA applauds their inclusion in S 1702.

The prohibition against insurance sales activity by bank holding companies is being advocated by some as encouraging competition rather than protecting the existing suppliers in the market. However, from a competitive standpoint, the consumer is better served if bank holding company subsidiaries can sell property and casualty insurance—the greater the number of insurance providers, the keener the competition, and the lower the price for consumers. While a consumer may purchase property and casualty insurance from a lender, there is no obligation to do so. Rather, the insurance agency market provides consumers with a wide range of sources from which to select insurance coverage with variations in quality and price.

The prohibition is intended to prevent one new category of new competitor from entering the market. In fact, the proposed prohibition might reduce the number of competitors already established in the market. Many, probably most, of the bank holding companies that now sell insurance entered the business coincidentally when they bought a mortgage company that also was an independent insurance agent. The insurance business came along with the mortgage business, and the company continued to serve both markets. Over the last two decades, a trend toward mortgage banking company and bank holding company affiliation has developed, and that trend is continuing. If the proposed restriction is enacted, bank holding companies will not be allowed to continue the insurance sales activity of a mortgage company which becomes a subsidiary, and a competitor will be lost from the marketplace.

Congress has delegated to the Federal Reserve Board the authority to define activities "so closely related to banking as to be a proper incident thereto." By regulation, the Board

has permitted bank holding companies to broker certain types of insurance. The Board's careful and judicious exercise of this authority was reviewed without objection by the U.S. Supreme Court in a 1978 decision as being within the statutory intent.¹

MBA believes that the sale of property and casualty insurance is related to banking, and that the public is well served when bank holding company subsidiaries sell this type of insurance. We urge the Committee not to restrict the sale of property and casualty insurance by subsidiaries of bank holding companies.

TRUTH-IN-LENDING ACT AMENDMENTS

There are four amendments to the Truth-in-Lending (TIL) Act contained in S 1720: a redefinition of "creditor"; a preemption of conflicting state laws; a clarification of appropriate civil liability; and an extension of the effective date of the Truth-in-Lending Simplification Act.

MBA urges that another amendment be added to exclude loans secured by mortgages on real estate from coverage by the TIL Act.

The proposed redefinition of "creditor" is important for the message it should carry for an even broader change. The Simplification Act, adopted in 1980, redefined "creditor" to include real estate brokers and others who arrange seller-financed sales. The failure to include this group in the coverage of the original TIL meant that some real estate borrowers were not receiving the TIL statement that the Act intended all to receive.

¹ See Alabama Association of Insurance Agents, Inc. v. Board of Governors of the Federal Reserve System, 533 F.2d 224 (5th Cir. 1976), on rehearing, 558 F.2d 729 (1977), cert. denied, 435 U.S. 904 (1978).

Consistency dictated that the gap be closed, and the 1980 Simplification Act did this, to be effective April 1, 1982.

As the effective date of this 1980 redefinition approaches, the enormous cost and confusion that this consistency would bring about is becoming clear. The start-up costs would be in the hundreds of millions of dollars. There are over a 1.5 million real estate agents in the United States. For each one to attend a one day seminar for a \$75 fee would exceed \$100 million in costs. Add in the necessary costs for legal advice, form printing costs, computer acquisition and programming, and office manual amendments, and the result is staggering.

The proposed redefinition would contract the 1980 expansion of TIL compliance coverage so that real estate agents who arrange owner-financing would not be required to furnish a TIL statement. The proposal acknowledges that the price of consistency is too high, and admits that Truth-in-Lending is not a universal good for all parts of the credit market.

This acknowledgement carries a message for broader redefinition of what should and should not be included in the coverage of the TIL Act. In 1968, at the last minute of its legislative development, the coverage of TIL was expanded for consistency to cover real estate financing. Just as the 1980 expansion should be reconsidered, so should the original inclusion of real estate finance.

Congress should remove from coverage of the TIL Act, all loans secured by a first priority mortgage on real estate, and all loans secured by a mortgage of any priority lien when the proceeds are used to purchase the real estate securing the loan.

TIL was designed for short term, relatively small balance consumer loans. However, the Act imposes an obligation on lenders making loans secured by mortgages on residential real estate, as well as consumer loans, to furnish a complicated statement of the loan expressed as an annual percentage rate (APR). The calculation of the APR is highly technical, and failure to calculate and disclose it precisely exposes a lender to heavy civil penalties.

The experience of MBA is that borrowers are not interested in APR—they are interested in how much cash they need to buy a house, how much the monthly payments will be, and what interest rate they will be paying. Some borrowers who are short of cash for a downpayment are interested in the premiums for the various types of mortgage insurance required on high loan-to-value rate mortgages. Sellers are interested in discount points when the points will be charged to them, as in the federally insured and guaranteed mortgage programs.

Different buyers and sellers of houses want to know different elements of the cost of buying a house and financing the purchase, because they want to balance the non-financial as well as the financial aspects of the transaction. For example, a larger downpayment can result in a lower monthly payment by the borrower, but it can also mean that the borrower does not have enough cash to install new drapes and carpets. Buyers and sellers are not interested in a single number aggregating all these elements, which is what the APR is. To the extent a buyer or a seller is interested in any element of the financing transaction, the information is readily available without the compulsory technical disclosure required by TIL in all instances.

Compliance with TIL is expensive. Even though the start-up costs that real estate brokers would face under the Simplification Act have already been incurred by the lending

industry, continued compliance means continual cost. Under present law, a TIL statement must be calculated, prepared, and furnished for each residential mortgage loan. MBA researchers estimate that in recent years between 2.5 and 3.0 million such loans have been made each year. In addition to the clerical time required for each statement, mortgage lenders incur costs for legal fees, training new personnel, re-programming for new developments, such as adjustable rate mortgages, printing of forms, and compliance examinations. The TIL Act has applied to real estate financing for over a decade. The experiment has demonstrated that the TIL approach is not successful for real estate lending. All loans secured by first liens on real estate and any loan the proceeds of which are used to finance the purchase of real estate securing the loan should be exempt from the TIL Act.

The other amendments that S 1720 would make to the TIL Act constitute beneficial technical adjustments. The distinction between substantial and non-substantial violation of the technical requirement of the TIL Act has long been urged by MBA. The postponement of the effective date for compliance with the Simplification Act would be useful if its only effect was to provide more time for adaption of the revised Regulation Z to the realities of the marketplace, but it could be extremely valuable if the extra time were used to consider the exemption from the TIL Act that MBA is proposing for real estate finance.

USURY PREEMPTION

MBA supports Title IV of S 1720 that would preempt state usury laws governing consumer loans and expand the current preemption of state usury laws governing business and agricultural loans.

Title IV recognizes that the Nation is no longer a collection of independent, localized credit markets, that may or may not be affected by national developments. Today, the market for credit is nationwide and rather than serving as protections for unsophisticated consumers, state usury laws serve as serious impediments to the free, interstate flow of commerce.

As we have said in the past, usury limits do not set interest rates, they simply restrict the flow of credit when market rates rise above the usury limit. The true determinant of interest rates—the interplay of the forces of supply and demand in the market—should set interest rates so that credit is available to consumers who can then choose if they wish to pay the market rate for credit.

Mortgage bankers are not in the consumer lending business except for second mortgage and home improvement loans. Purchase programs for such loans by both FNMA and FHLMC should create a greater availability of funds for these loans, and we anticipate that mortgage bankers will become more active in this area of lending. Title IV would remove state-imposed impediments for lenders who wish to offer second mortgage and home improvement loans to consumers, and thus will truly benefit consumers.

Thank you very much for this opportunity to testify. I would be happy to answer any questions you might have.

**POTENTIAL PROBLEM AREAS FOR ADJUSTABLE RATE MORTGAGES
STATE-BY-STATE ANALYSES**

<u>STATE</u>	<u>PROBLEM</u>
FLORIDA	Case law may prohibit loans with negative amortization originated by mortgage bankers.
GEORGIA	Statute may prohibit negative amortization.
HAWAII	Statute prohibits recovery of compound interest.
IDAHO	UCCC restrictions on balloon payments where interest rate exceeds 13 percent may cause potential problems with respect to SAMs.
INDIANA	UCCC restrictions on balloon payments would prohibit SAMs. UCCC disclosure requirements may cause problems with respect to all ARMs.
IOWA	VRM statute imposes restrictions. Poses problems with respect to federal regulations on ARMs.
KANSAS	Floating usury ceiling in effect.
MAINE	UCCC disclosure requirements may cause problems with respect to ARMs.
MARYLAND	Possible regulatory restrictions for S&Ls on VRMs and ROMs.
MASSACHUSETTS	Possible regulatory restrictions with respect to VRMs and RRM.
MICHIGAN	Statute prohibits increases in initially effective interest rate.
MONTANA	Interest on interest may be prohibited by old case law.
NEVADA	Old case law may prohibit interest on interest.
NORTH DAKOTA	State statute requires all contracts to bear same rate of interest after maturity as they bear before maturity. Potential problem with respect to RRM and ROM. In addition, statutory law may prohibit interest on interest.

<u>STATE</u>	<u>PROBLEM</u>
OHIO	Negative amortization may be prohibited as a result of Ohio case law.
PENNSYLVANIA	VRM statute imposes limitations.
RHODE ISLAND	Statute requires that loans with certain loan-to-value ratios must provide for monthly payments of principal and interest in substantially equal amounts.
SOUTH CAROLINA	VRMs prohibited on loans under \$100,000.
TENNESSEE	VRM statute imposes potential restrictions.
VERMONT	Possible regulatory restrictions for banks and S&Ls with respect to VRMs.
WEST VIRGINIA	Interest rate increase in mortgage contract prohibited by statute. Old case law prohibits interest on interest.
WISCONSIN	VRM statute imposes limitations on state-chartered lenders.
WYOMING	UCCC restrictions on balloon payments may preclude SAMs.

ABBREVIATIONS

VRM	Variable rate mortgage
ARM	Adjustable rate mortgage
UCCC	Uniform Consumer Credit Code
SAM	Shared appreciation mortgage
RRM	Renegotiable rate mortgage
ROM	Roll-over mortgage
S&L	Savings and loan association
GPM	Graduated payment mortgage

Source: Mortgage Bankers Association of America, October 1981

**STATES WHERE THE EXERCISE OF
DUE-ON-SALE CLAUSES IS PROHIBITED OR RESTRICTED**

Arizona
California
Colorado
Florida
Georgia
Illinois
Iowa
Michigan

Mississippi
New Mexico
Ohio
South Carolina
Utah
Washington

Source: Mortgage Bankers Association of America, October 1981

TITLE VIII

SECTION 1. As used in this Title—

(1) the term "Adjustable Rate Mortgage Loan" means any mortgage loan that does not carry a fixed interest rate, or a fixed schedule of payments, or is not self-amortizing or does not amortize each year of the entire term of the loan or mortgage.

(2) the term "Qualified Lender" means—

(A) any lender approved by the Secretary of the Department of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act;

(B) any state bank as defined in Section 3(a) of the Federal Deposit Insurance Act (12 USC 1813(a));

(C) any mutual savings bank as defined in Section 3(f) of the Federal Deposit Insurance Act (12 USC 1813(f));

(D) any savings bank as defined in Section 3(g) of the Federal Deposit Insurance Act (12 USC 1813(g)); and

(E) any building and loan, savings and loan, homestead association, or cooperative bank organized and operated according to the laws of the State, District, Territory or possession in which they are chartered or organized and whose accounts are insured pursuant to Title IV of the National Housing Act (12 USC 1730).

(3) the term "State" includes the several States, the Commonwealth of Puerto Rico, the District of Columbia, Guam, the Trust Territories of the Pacific Islands, the Northern Marianas Islands, and the Virgin Islands.

MAKING OR PURCHASING ADJUSTABLE RATE MORTGAGE LOANS

SECTION 2. Without regard to any limitations that otherwise would be imposed on such a lender by the constitution, statutes, court decrees, common law, rule, and public policies

Appendix 3

of any states, a qualified lender may make or purchase home mortgage loans in conformity with regulations promulgated by the Comptroller of the Currency that establish rules for national banks making or purchasing adjustable rate mortgage loans or in conformity with regulations promulgated by the Federal Home Loan Bank Board that establish rules for federally chartered savings and loan associations making or purchasing adjustable rate mortgage loans.

INTERPRETATIONS

SECTION 3. The Federal Home Loan Bank Board is authorized to issue rules and regulations and to issue interpretations governing the implementation of this Act.

Appendix 4

PHLMC-FNMA OLD LOAN PURCHASE LIMIT

SECTION 173

- (b) Section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act (12 USC 1454 (a)(2)) is amended by inserting after the third sentence the following:

"Any conventional mortgage, originated more than one year prior to the date of purchase that is purchased by the Corporation during the 12 month period commencing with the date of enactment of the statute containing this provision, shall not be considered a mortgage originated more than one year prior to the date of purchase for purposes of the volume limitation contained in the preceding sentence."

- (c) Section 302(b)(2) of the Federal National Mortgage Association Charter Act (12 USC 1717(b)(2)) is amended by inserting after the fourth sentence the following:

"Any conventional mortgage, originated more than one year prior to the date of purchase that is purchased by the Association during the 12 month period commencing with the date of enactment of the statute containing this provision, shall not be considered a mortgage originated more than one year prior to the date of purchase for purposes of the volume limitation contained in the preceding sentence."

The CHAIRMAN. Mr. Shimberg.

Mr. SHIMBERG. My name is James H. Shimberg. I am a home builder from Tampa, Fla., and I am currently serving as chairman of the Mortgage Finance Committee of the National Association of Home Builders on whose behalf I testify. As you know, the NAHB represents over 123,000 member firms in the housing industry.

The position of the housing industry on the bill before you is crystal clear. We are unalterably opposed to those portions of the bill which might turn savings and loans and mutual savings banks into commercial banks and, as we see it, dismantle the thrift industry. At the same time, as the savings and loans' biggest customer we recognize the present desperate plight of the thrift industry. We support those portions of the bill, which I understand come from the chairman, which address the current crisis and allow and encourage where necessary, mergers and acquisitions, the so-called regulators' bill.

FUTURE HOME BUYERS SUFFER

Everyone seems to recognize the housing industry as well as the thrift industry is in severe trouble. The only debate seems to be whether we or the automobile industry are worse off. Your concern, however, need not be for the homebuilder, but rather for the inability of the average American, particularly the first-time home buyers, to buy a decent home at a price they can afford. The present crisis is bad enough. It can't be anyone's desire to make it worse. We believe that some of the legislation before you today could do that.

Ever since World War II, the savings and loans and mutual savings banks have been the prime source of home mortgage financing. They have been the only financial institutions who saw as their prime function—their reason for existence—the twin objectives of promoting savings and homeownership. Mortgage lending is merely one of many departments of the commercial bank or the insurance company. Unfortunately, the pension funds, in general, don't even like to consider residential mortgages.

If the vast knowledge and expertise which exists in the thrift industry and which for many years has concentrated on promoting savings and making homeownership possible for more and more Americans—changes directions and retools as commercial bankers, consumer lending experts, and security salesmen—the future of the American homeowner will suffer.

Let's be clear about something else. Yes, the saving and loans are in severe trouble and the homebuilder has never seen it worse—at least I haven't—but over the past three decades we have jointly done a great job—70 percent of Americans own their own home today—they feel a stake in their community—this didn't just happen—it was the partnership of the thrift industry and the homebuilder which brought it about. Don't our children deserve the same opportunity to live in the housing that we have had?

I think we would all agree that the plight of the thrift industry and the homebuilder and home buyer stems from the same cause—high interest rates. But I hope we all agree that short-term rates will decline—someday, hopefully soon—a 3- or 4-percent decline in the cost of money would cure most of the immediate savings and loan

problems—but a shift in emphasis of the savings and loans from mortgage lending to consumer loans would probably be permanent.

Look at what happened in just the past year or so. Regulation Q is being phased out, mortgage interest rates are at all time highs, well beyond the reach of almost any American. The fixed rate, long-term mortgages, the mainstay of the American family, are said to be a thing of the past. Adequate credit for housing, the mortgage interest deduction and the FHA are under attack, we are trying to explain a new alphabet to the home buyer—ARM, GPM, SAM, RRM, and the like. For all of those needing a home, this is truly a revolution.

It seems like an inappropriate time—truly an impossible time from the point of those of us who have spent our lifetime trying to provide housing for the American public—to redirect the attention and function of the thrift industry from mortgages to commercial banking. And by the way—no one has maintained that such redirection is a quick fix—only a reduction in interest rates will really help.

One final word—if this drastic change in financial institutions—particularly the savings and loans is inevitable and the thrifts are no longer to be the prime source of mortgage finance—consider who might take their place—there is a logical candidate. The pension and profit-sharing funds are the largest single source today of long-term money. They don't borrow short and lend long. Their earnings are tax free. In exchange for this tax exemption, some mandatory requirements to invest a small portion of their assets to house America might not be inappropriate.

We stand ready to work with this committee to chart the path of a new direction for mortgage finance—if that is what is necessary. We would strongly urge that these hearings be broadened to discuss the long-term need for mortgage credit—and how that need would be met—prior to committee consideration of the landmark legislation before you today.

We appreciate the opportunity to present our views today and look forward to working with this distinguished and thoughtful committee and its highly competent professional staff. I am certain that there are questions for this panel—and I would be happy to try to answer them.

[Complete statement follows:]



National Association of Home Builders

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STATEMENT OF
THE NATIONAL ASSOCIATION OF HOME BUILDERS
before the
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
on
FINANCIAL INSTITUTIONS RESTRUCTURING LEGISLATION
OCTOBER 21, 1981

Mr. Chairman and Members of the Committee:

My name is James Shimberg and I am a homebuilder from Tampa, Florida. I am testifying today on behalf of the more than 123,000 members of the National Association of Home Builders (NAHB). NAHB is a trade association of the nation's home building industry, of which I am a Member of the Board of Directors and Chairman of its Mortgage Finance Committee. Accompanying me today are Robert D Bannister, Senior Staff Vice President for Governmental Affairs and Jim Schuyler, Staff Vice President and Legislative Counsel.

Mr. Chairman, we appreciate the opportunity to appear here today to discuss the merits of this far-reaching and controversial legislation.

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We traditionally present a brief review of the condition and short-term outlook of the housing industry when we appear before Congress. However, today, I believe an understanding of the economic outlook of the housing industry is crucial to an understanding of our position on the legislation before you today.

HOUSING OUTLOOK

It has become clear that housing -- both new production and the existing market -- is going through its most severe downturn since 1946.

- o Housing is now in its 34th month of a recession, the longest post-war recession on record.
- o Conventionally-financed single family housing has been hardest hit during this recession. Single family housing has already declined by 61.2 percent from peak to current "trough." This is the sharpest drop since the Depression -- and we do not know when it will hit bottom.
- o Total housing production for 1981 is forecast at only 1.06 million, a 19.2 percent drop from the 1.31 million units in 1980 -- which was 25 percent below the 1979 level.
- o The NAHB Econometric forecast for 1982 shows another very low year for housing production. Our best assumption of a decline in all interest rates (T-bill rate dropping to 12 percent by the end of 1982 and the prime rate declining to 16 percent) produces only a modest improvement on housing production to 1.29 million - still one of the worst years in the last three decades. Assuming a more gradual decline in rates (prime dropping to 18.5 percent by mid-1982), housing production would be only slightly better than 1981 by possibly 100,000 units. Any higher level of production would be dependent upon a positive impact of the all-savers certificates which should help the thrift industry improve its spread.
- o The inventory of unsold homes is about 500,000 units. That represents about \$33 billion in value, \$23 billion in construction loans and a carrying charge of \$5 billion in annual interest.
- o Unemployment among construction wage and salary workers is at 16.3 percent, with 828,000 people out of work. An additional 200,000 should be added for formerly self-employed. We expect construction unemployment to increase to at least 21 percent in December and possibly to 22.5 percent during the early

- part of 1982.
- o Failure rate among construction firms is up 41% over last year, failures among subcontractors are up by 127%.
 - o New housing production for September was at 918,000 units, 38 percent below one year ago, the third lowest recorded monthly rate.
 - o Mortgage money is not generally available, and what is being offered is at record rates. Freddy Mac yields were over 18% in mid-October.
 - o Depressed housing production will have a major impact on unemployment and will spread into most sectors of the economy, leading to another two quarters of negative growth in the Gross National Product.

In short, housing activity has come to a standstill across the country in the face of persistent high interest rates. And our nation's homebuilders are fighting for survival against mounting odds. In fact, Professor Kenneth Rosen, of the University of California at Berkeley, has observed that "it is likely that even the remaining low levels of activity will collapse in response to the record high interest rates plunging the housing sector into an outright depression and the overall economy into a severe recession." Mr Chairman, we sincerely hope not...but current signals are not very encouraging.

ECONOMIC IMPACT

What has been the economic impact of the housing slump? From the beginning in 1978 until today, we estimate that this housing downturn has cost the American economy more than 2.8 million man-years of employment, \$49.2 billion in wages and \$15.7 billion in total tax revenues. The total overall economic impact has been \$223 billion.

The long-term effects will be at least as damaging. The record demand for housing will continue to go unmet, thereby increasing inflationary pressures during the housing recovery. Thousands of

skilled craftsmen have sought employment elsewhere and will not return as the housing industry rebounds. Consequently, a new work-force will have to be trained when economic conditions improve. Building material manufacturers have gone out of business and others have indefinitely delayed any plans to expand production capacity. As in past housing cycles, we will find serious shortages of building materials when production picks up. All of this translates into higher housing prices for housing consumers in the future -- young families who are already stretched to the limit of their ability to pay.

Finally, I believe that we will see a major shift away from the "small business" character of this industry when the market is revived. As I said earlier, business failures are up by 41% over last year, and the smallest and least capitalized firms are the ones which are most likely to go under. The net result will be fewer and larger building firms and a massive influx of foreign capital to purchase developed land and building firms. And, Mr. Chairman, that would be a real tragedy. This industry could lose one of its basic strengths if we lose our base of smaller, fiercely independent and competitive builders.

THE HOUSING CONSUMER

What more can I say to this Committee regarding the homebuying and renting public? We have emphasized repeatedly in our appearances before this Committee the record demographic demand for housing during this decade. Projections indicate that in the 1980's some 41 million people will reach the prime homebuying age of 30. This compares with about 31 million who reached the age of 30 during the 1970's. The rate of new household formations will be 25% higher in the 1980's than

during the last decade. All I can add is that if housing production is at about the one million level for the first two years of that decade, we will fall even further behind in meeting that demand and will see a house price explosion whenever the constraint of interest rates is minimized. And I believe that unless this demand is met, housing will become a major issue at the ballot box in 1982 and 1984.

Let me quote from a letter to the editor of the Business section of the New York Times just a few weeks ago. "If Mr. Average American can no longer own his own home, what does that do to his sense of involvement? Think about it. Lack of mortgage money will tend to destabilize the United States." We share the view that homeowner and the ability to live in decent and safe housing gives our people the chance to become a part of the capitalist system. Historically, this has led to a strong middle class, which reflects political stability and security. The ability to own a home is still a fundamental part of the American dream and a continuing aspiration for almost all of our people.

But what is today's reality? Unfortunately, the numbers on affordability tell the sad story simply but graphically.

A modest \$60,000 mortgage loan at 9% interest - the going rate two years ago - required a monthly payment of \$483. At 16 1/2%, the payment is \$831 per month, almost double the payment of two years ago. In order to meet those monthly payments, a family would need an annual income of almost \$40,000. Only 19.5 percent of the American people have an income high enough to afford that home, and virtually no first-time homebuyers would qualify for a home at those high interest rates.

THE STATE OF THE THRIFT INDUSTRY

High interest rates have impacted the thrift industry as seriously as the housing industry. The spread between what the thrifts must pay to attract deposits and income from their portfolios is unprecedented. Between June 1978 and August 1981, the average cost of funds to savings and loans rose from 6.61% to 11.31%, while the yield on S&L portfolios increased from 8.49% to 9.79% during the same period. Further, the fantastic growth of Money Market Mutual Funds (MMMFs) over the past year has contributed to a large outflow of funds from the thrifts. The Federal Home Loan Bank Board's (FHLBB) list of troubled institutions continues to grow, while many of our nation's most established savings institutions are seriously threatened. And most ominously, there are serious questions as to the ability of the FDIC and FSLIC insurance funds to cover insolvencies.

EMERGENCY LEGISLATION

To deal with the imminent emergency situation of the thrifts, the financial institution regulatory agencies developed the so-called Regulators' bill. This bill would give these agencies more flexibility to deal with insolvent institutions and would in very serious cases allow the arrangement of mergers between institutions. Frankly, Mr. Chairman, the prospect of interstate and cross-industry mergers potentially involved in this bill does not appeal to us. The American housing industry and homebuyer have long thrived with a housing finance system based on small community thrifts. However, we see no other viable alternative to the immediate situation. An increased flow of credit from the Treasury to the FSLIC is out of the question due to budgetary constraints. Proposals such as "warehousing"

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mortgages would cost exorbitant amounts. If there is a recognized emergency and a danger of a loss of public confidence in our financial institutions, we believe that Congress should expeditiously enact the provisions of the Regulators bill.

FINANCIAL RESTRUCTURING LEGISLATION

Mr. Chairman, there are two key points I would like to make regarding the Administration's proposed restructuring bill (which will forever be known as the "Pratt" bill - S. 1703) and the Chairman's bill (S. 1720).

First, we seriously question the timing of this legislation. The Chairman of the Federal Home Loan Bank Board has recognized that this bill is not designed to meet the short-range problems of the thrift industry. There is no question that it is certainly not intended to assist the collapsing housing industry. The increased powers given to thrift institutions under this bill amount to a virtual rewrite of the Home Owners' Loan Act of 1933 and could lead to a dismantling of the existing system of housing finance.

Mr. Chairman, it is not my intention to state that this legislation is being considered too quickly or that the issue will not be fully presented and analyzed...or that they have not been well discussed in the past. In fact, my views on this subject have changed little since I read the additional views of my builder colleague, Morgan Earnest, in December 1971 in the Hunt Commission report. He observed that the Commission's recommendations failed in one single critical area -- "coming to grips with the overriding problem of providing a more stable flow of funds into the residential market." He further observed that expansion of mortgage institutions into other related

and unrelated areas may have "validity" but "if this is carried too far, the mortgage market would become more of a residual claimant for funds than currently." And expansion into broad categories such as consumer lending "would mean less funds for home loans, a construction of residential construction and a negation of national housing goals." Regarding direct investment by thrift institutions in real estate as undertaken by savings and loan service corporations, he observed that "it is difficult to understand how... [this] will benefit either the homebuyer or the housing industry."

Second, for the last several years our financial system, due to changing market and technological conditions, has begun to move from a highly regulated to a so-called "free-market" oriented system. I believe, as Professor Ken Rosen has said, that the housing finance system is in a "transition crisis." This crisis must be evaluated in light of the record demand for housing and current low levels of housing production.

There have been many significant changes which are underway already which will strengthen the thrift industry and may well preempt the need for thrift institution restructuring legislation. We urge the Congress to at least wait to see if these actions will work before embarking on a major restructuring of the thrift industry.

We ask that you consider the impact of the following changes that have all taken place within the last year:

- o The Depository Institutions Deregulation and Monetary Control Act of last year provides for the phase out of Regulation Q. The act substantially expands the scope of investments which thrifts can make;
- o The Federal Reserve Board's discount window has recently been opened to troubled thrifts;

- o The Federal Home Loan Mortgage Corporation (FHLMC) has announced a program which will provide \$10 to \$20 billion in increased liquidity to the thrifts in 1982. NAHB supports the provision of S.1703 and S. 1720 which would remove the limitation on the number of mortgages more than one year old that the FHLMC could purchase;
- o The Federal Home Loan Board recently issued regulations for new accounting procedures which will allow S&Ls to amortize the loss from the sale of below market rate loans over a longer period;
- o Sales of All Savers certificates met or exceeding expectations at most thrifts across the country during the first week of their offering. These certificates should lower the net cost of funds to the thrifts; and
- o The availability of alternative mortgage instruments such as the adjustable rate mortgage (ARM) should ensure that the thrifts can offer mortgages in the future which reflect current market rates. We would like to see the regulatory agencies and the secondary market lead the effort to standardize the ARM investment in order to increase consumer and market confidence. (See Attachment A)

WHAT ABOUT HOUSING?

At a time when housing is at its lowest levels of production since World War II, there appears to be an uncoordinated but real political attack on housing and housing finance - just when a record number of young families are about to enter the housing market.

What are the elements of this attack?

- o A broadside against the basic FHA insurance and VA guarantee programs by restricting the essential secondary market provided by the GNMA mortgage-backed security program and the actual FHA commitment level as well. These programs have helped to provide for 27 million Americans since the inception of the programs some 40 years ago. Many of the beneficiaries of the programs would not otherwise have been able to become homeowners.
- o An attack by the Office of Management and Budget on the federal "benefits" given to the Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporations. (FHLMC).
- o The Treasury Department's position opposing legislative changes essential to allow for a workable tax-exempt revenue bond program for single-family and multi-family housing.

- o Recent critical examination of the basic homeownership interest deductions, which represents the most significant Federal encouragement of homeownership.
- o Continued assertions that too much credit is going to housing even though the most critical problem facing housing in this decade is lack of an adequate and stable supply of affordable credit.
- o Over reliance on a tight monetary policy which has helped to create extremely volatile financial market conditions and a catastrophe for the housing industry and the housing consumer.

And now...the Financial Institution Restructuring Act. The only recognition by Treasury Secretary Regan in his written statement on Monday of the impact of this proposal on housing finance is his assertion that "providing thrift institutions with new asset powers need not diminish their contributions to housing finance." If, as the Treasury Secretary states, thrifts "are likely to continue expanding" their real estate lending activity, why is there a need for unlimited expansion of their powers? If Congress is now running the beach crying "shark" about thrifts' mortgage investments and the need to diversify, when will you tell the thrifts that it is "safe to get back in the water?" And will the housing consumer be the first... and only...victim of JAWS?

In addition, what assurance is there that it is in the interest of thrift institutions to diversify into consumer or commercial loans? Secretary Regan indicates that "their area of greatest-expertise" is real estate lending. Federal Reserve Board Vice-Chairman Frederick Schultz has observed that such an expansion of powers could greatly endanger the financial stability of the thrifts because of their lack of expertise and the great pressure on the thrifts to hastily move into these new areas.

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Mr. Chairman, we recognize the need for adjustment to new realities in the financial system. And we would support the transition to any new system which would lead to a more efficient, equitable, adequate and stable flow of mortgage credit. However, the thrust of this bill is in the opposite direction, and no consideration has yet been given to the development of an alternative mechanism for providing housing credit.

SAVINGS AND LOAN SERVICE CORPORATIONS

NAHB opposes the provisions in S. 1703 and S. 1720 which would increase from 3 to 5 percent the portion of assets which thrifts can invest in their service corporations. There should not be any increase in the power of S&L service corporations unless it is ascertained that service corporations are not involved in anti-competitive business practices and are not in violation of anti-trust law. NAHB's members across the country have noted an increase in anti-competitive business practices by service corporations engaged in direct development, construction and sales of new housing. We are most disturbed by the practice of S&Ls offering below market rate mortgages to consumers purchasing new homes from in-house corporations, while purchasers of resale housing or new homes built by independent contractors are denied financing or are forced to pay much higher rates of interest. The legislative history of S&L service corporations indicates a desire by Congress to permit S&Ls to pool resources for the purchase of data systems and the establishment of processing centers, not for real estate development activities.

NAHB has documented evidence in Saginaw, Michigan; Greenville, South Carolina; and Wheaton, Illinois of anti-competitive activities

by service corporations such as refusals to deal with unaffiliated builders and lending at differential interest rates. In some instances, builders have been driven out of business. In Saginaw, service corporations controlled approximately 75 percent of the buildable lots. NAHB was able to rectify the situation by bringing this issue to the attention of the offices of the state Attorney General and the state bank regulators. The service corporation activities were found to be in violation of Michigan state anti-trust law. In Greenville, four service corporations control over 2800 lots in the two county metro area. Lenders are reported to refuse to deal with builders who are not in joint venture or otherwise affiliated with service corporations. The Greenville situation has not been resolved. We believe that this issue has not been adequately dealt with by the Federal Home Loan Bank Board. And such activity does not create the so-called "level playing field" which was discussed most recently when Treasury Secretary Regan proposed even further expansion of direct real estate investment by thrift institutions and commercial banks in his testimony on Monday. We must remember that some Romans believed that the Christians and the lions were competing on a "level playing field" at the Colosseum.

COMMERCIAL BANKS-REVENUE BONDS

I would like to express our support for Section 301 of S. 1720, which would authorize commercial banks to underwrite municipal revenue bonds. NAHB has had policy supporting similar legislation for several years and believes that it is important that this legislation be enacted. While high interest rates and inflation have sharply restricted our ability to produce needed housing, the homebuilding

industry has for many years been confronted by soaring land prices. This has been largely brought about by a shortage of sufficient developable land with utilities and other public facilities available to serve prospective residents. These utilities and facilities are provided by local governments who must turn to the capital market to finance their construction. Most often, local governments issue revenue bonds which banks are ineligible to underwrite. The expanded competition that banks will give for these bonds will help bring down their cost and, therefore, make it easier for local governments to provide the infrastructure needed to support housing in their communities.

CONCLUSION

Mr. Chairman, some have said that the future of housing is not tied to the future of the thrift industry. And that may be true. We recognize the need to tap new resources in the credit market and we know that pension funds represent the single largest part of long-term investment capital today with assets of \$600 billion. Public and private pension funds are expected to reach a level of \$1.3 trillion by 1985. We may be willing to shop at Sears; we are as bullish on America -- and the long-term prospects for housing -- as Merrill Lynch. But in the atmosphere of chaos and uncertainty in the financial markets today, please do not alter the path we have followed successfully for the last 50 years.

We stand ready to work with this Committee to chart the path of a new direction for mortgage finance -- if that is what is necessary. We would strongly urge that these hearings be broadened to discuss the long-term need for mortgage credit -- and how that need would be

met -- prior to Committee consideration of the landmark legislation before you today.

We appreciate the opportunity to present our views today and look forward to working with this distinguished and thoughtful Committee and its highly competent professional staff. I am certain that there are questions for this panel...and I would be happy to try to answer them.

PUZZLEMENT, FRUSTRATION, AND INTRAMURAL FIGHTING

The CHAIRMAN. Let me repeat what I said when I introduced this legislation. I did not necessarily agree with every piece in it, but I wanted to put it out on the table so that it could be discussed. Too often we hide these issues under the table or someplace, and I felt it was time we started discussing it. I have no pride of authorship. As a matter of fact, S. 1720 is a consolidation of many Senators' bills.

I agree with some of your specific criticisms. I would also say that this legislation is no panacea. If it were all enacted tomorrow, it would not solve the basic problem, which is the cost of money. There is no doubt about that. I don't want you to think that anybody on this committee feels that it would.

But I am really just as puzzled with all of your testimony in general today, even though I agree with some of the specifics, as I was the testimony of the ABA and the Independent Bankers yesterday. When we held hearings in April and May, all we heard about was money market mutual funds. You can read the record. Everybody was here testifying. That is our competition. What are we going to do about it? The world was coming to an end in April and May.

Well, if it was bad in April and May, it is even worse now, because, boy, the funds are still growing. They have been growing rapidly, and even if interest rates came down tomorrow, they are not going to go away.

The merger of American Express and Shearson, Prudential, Bache, all of the things we have discussed, those new types of players are going to stay. They are simply not going to go away. So my puzzlement and frustration with the testimony is that all I have heard is the intramural fighting that has gone on between realtors, S. & L.'s, banks, and so on. And I've heard almost nothing these 2 days about the new boys on the field. I would gather from the testimony of the last 2 days that who must be cheering is the securities industry association. They must be happy as hell at what they've heard the last 2 days. Nobody has laid a glove on them. Nobody seems to be worried about them at all.

So Mr. Wood and others talk about concentrations. All of you have known me long enough to know how I feel about those concentrations. No doubt about it. We are struggling for some middle ground to prevent the concentration from all of these players that do not have to play by the same rules.

So I say, as an editorial comment, I am puzzled. As I said to the ABA yesterday I will say to you gentlemen today. If we do not get together on some compromises, you can go right on with your intramural warfare, while the Merrill Lynchs' and the Sears take all of your business away.

You talk about concentrations, Mr. Wood. I'm telling you we are seeing that in your business every day. Sears, Coldwell-Baker, Merrill Lynch; S. 1720 has nothing to do with them, nothing whatsoever. You're being concentrated by the big boys all at once. I would ask any of you in general, where are we going? If all of these disagreements continue the only people who are going to benefit are the new boys on the block. And I guarantee you they will, while you guys argue about your individual differences. Here we have got the S. & L.'s saying they still want to be mortgage lenders, and on this side of the table we are saying that this legislation would destroy it.

Any general comments? Mr. Wood?

Mr. Wood. Mr. Chairman, in our broader statement we did look into that a little bit more deeply than, of course, in my oral statement. We are deeply concerned about that. One of the main reasons that we would hate to see this go ahead right now in the form that it is, is we think we need to look into that. We think Congress needs to look into that and try to approach that problem, because by allowing the thrifts and the banks to get in and be able to compete with the money market funds, by having a money market fund or doing the things that the others are doing, it is not going to solve that problem, because they are unregulated, which is what you just addressed.

We think you ought to look at the possibility of some type of regulation on those people that are getting into the financial field.

The CHAIRMAN. Not this Senator. I have spoken at every one of your national conventions, and you have always given me standing ovations, every one of your groups when I talked about deregulations and getting government out of your business. I cannot accept testimony from the small businessmen of this world, the home-builders, realtors, particularly, who are the epitome of small businessmen, to have government stick it to somebody else.

Mr. Wood. I did not say that. I said to investigate and see about that, because they are entering into fields which are regulated, and taking all of the regulations off everybody else may not be the solution, because the small businessmen in America may be the victims of that. That's what I'm suggesting.

The CHAIRMAN. Once again, even if the interest rates came down, I think after 30 to 40 to 50 years of some of these regulations, the route I want to go is to amend those regulations, to remove government. That is part of the President's program, besides tax relief, besides cutting off expenditures. It is to remove the burden of government regulation. I am not going to start looking for new regulation to try and create fair competition. Right now, as

you have heard me say many times, there is an incredible amount of unfair competition going on by groups that do not have to abide by the rules and regulations,

This is an attempt to examine that and see where we go. I am interested.

Mr. Brooks, could I ask you to comment on the testimony of the realtors and the homebuilders that all you savings and loan people are going to run and never offer another mortgage?

Mr. BROOKS. I'm glad you asked that question. What we're talking about here is survival of the savings and loan business, and if the savings and loan business does not survive, there will not be the money out there for the realtors and the homebuilders. Believe you me, the realtors and homebuilders are still our customers. They are our best customers, and I think they will be in the future.

What we are talking about here are profit centers, if you will—means by which we can make some money, stay alive. And I think you will find that most of the S. & L.'s will be continuing to make home loans, both in new construction and existing housing sales.

Now you made a reference to the big ones like Sears and the rest of them. I would think that even with the bill that you have here, giving us additional powers, it would still be tough to try to compete. I am president of a modest size association. But I could pick and choose from these powers: first, to allow me to earn enough money to stay in the home mortgage market as much as possible, and also to carve out my niche locally, if you will, in my area, so that I can continue to survive and carry on my business.

I certainly cannot compete with Sears, but I think that with these powers I can stay alive. We do know, and I agree, and I have stated in my testimony that this is a longrun solution. We have to seek solutions in the short run, too. But if we do survive and we have no longrun solutions, the ball game is over, as far as I can see, for housing in America.

BILLIONS DRAINED FROM DEPOSITORY INSTITUTIONS

The CHAIRMAN. Are you aware of the \$150 billion drained out of depository institutions? Is anybody making mortgage loans with that?

Mr. BROOKS. I have not heard of any mortgage loans being made with it. It is my understanding that it is going to the big money center areas in this country. We have in our testimony, of course, some recommendations. You have just stated how you feel about regulating the money market funds, but certainly those funds are being drained out. Certainly, their investments are not returning to my area.

The CHAIRMAN. They are not only being drained out of the traditional institutions, out of the small States. I am not aware of it staying in my State. We support New York quite well with our loan guarantees and bail out New York without taking Utah and Idaho and all the small States money.

I'm trying to make a point, gentlemen. We have a serious problem with the new type of investment community getting into the traditional, and this is an attempt to explore how to solve that. I only make the point, those who are being harmed the most, and the associations you represent today are the ones and we could

include the automobile dealers. You are the ones that are being hurt the most by this.

I think we have to come to some kind of conclusion.

Mr. Wood, could I ask you one question I am a little puzzled with. We had a discussion some months ago about due-on-sale, and you hastened to assure me that the national association had a different position than some of the State associations and did not agree with the prohibitions on due-on-sale. Is your testimony today a change in that position at the national level?

Mr. Wood. No; I think you will find that I said at that time, and I quote, "It is the policy of the national association to allow due-on-sale to work." And you remember I explained, Mr. Chairman, at that time that our position from a policy matter was accommodation at the local level, that we urged our local boards to go work out accommodations, and we believed in 80 to 85 percent of the cases that had been reported it was working. They were allowing assumptions at below market rates.

And I said at that time, somebody is going to have to speak to this, and the Congress very wisely spoke and not just to the narrow due-on-sale provisions that will not be here after a few years or maybe a few months. They addressed the problem with the all savers, Keough, IRA bill to bring in money to the savings and loan. The low portfolio was addressed recently by allowing S. & L.'s to write off the loss from the sale of old, low-yielding mortgages over the length of a mortgage and also to sell them into the secondary market.

Purchase programs have been developed by FHLMC and FNMA to get rid of low portfolio loans.

And then we have the adjustable rate mortgage now. We think they should be allowed to see if they are going to work, rather than going in and having a Federal preemption on due-on-sale. One of the main reasons is our market, and you are as aware of it as anybody, has deteriorated much since May. About 50 percent of our transactions now, Mr. Chairman, are being made with what we call creative financing, and in the State of California where enforcement of due-on-sale is prohibited, about 70 percent of them involve assumptions. If you have a Federal preemption on due-on-sale, we believe that creative financing would effectively be wiped out, and we would lose as many as 752 million sales that are occurring now.

The CHAIRMAN. The due-on-sale with a 3-year right for State legislators to change that. I would disagree with Mr. Coles. As a former mayor, I have a great aversion to Federal preemption of anything, and therefore, I cannot support elimination of due-on-sale, unless the State legislatures are given the opportunity to decide. Whether I agree with them or not is not the point. That is a States rights issue as far as I am concerned.

So I will insist that if that provision goes forward, that it does give the States the opportunity to have 3 years to say we do not agree with you big bad boys on the Potomac.

Mr. Wood. The next 3 to 6 months is crucial in our business. We have many hanging on by their toenails, and the 3-year State override would not allow the State legislatures to come in, quickly enough, particularly if they are not meeting in that time, or to

have a special session, which is very costly. They might not be able to react for a year or a year and a half, and by that time the real estate market may have collapsed. We are just concerned about the timing, Mr. Chairman.

The CHAIRMAN. Senator Proxmire?

Senator PROXMIRE. Thank you, Mr. Chairman.

Gentlemen, I cannot resist asking this panel, because it is an expert panel on housing, if ever there was one, in financing and building, real estate, and so forth, if you all agree the Federal Government should follow policies just as strictly as possible to get interest rates down, including reducing spending, increasing taxes, if necessary, and somehow getting the Federal Government to withdraw as much as possible from the credit markets. Do you all agree on that? Is there any disagreement?

Dr. RIEDY. I agree with the idea that we have to rebalance public policy, a tighter fiscal policy, which would allow for a somewhat easier, faster growth rate in the money supply using M1-B. But in terms of the credit ceilings and the concern about the overall contingent liability of the Federal Government, the Mortgage Bankers Association does not agree, especially with respect to the FHA and Ginnie Mae programs, not only because they have been self-supporting over all of their years. I am talking about the unsubsidized programs.

Senator PROXMIRE. I want to get away from that kind of specific, housing-oriented consideration. I am talking about broad Federal policies to balance the budget, to reduce Federal spending, to overcome the deficit, to get us out of the off-budget borrowing area, that kind of thing. The reason I raise that is because yesterday the Chairman of the Council of Economic Advisors, Mr. Weidenbaum, and a former Chairman, Walter Heller, seemed to agree that we are in a recession or moving in a recession, and therefore we ought to be pretty careful about either increasing taxes or cutting spending further. In fact, Walter Heller dismissed the proposal the President has made to make a \$16 billion reduction in the deficit by saying we ought to drop that silly notion. Mr. Weidenbaum said we have baked into the cake now, with the great tax cut, an antirecession policy.

It seems to me that if we follow that kind of overall economic Federal policy that you gentlemen are doing, you're doomed, if we are going to have a deficit that is going to get deeper, \$60 billion, \$70 billion. Then you're going to have all of the off-budget borrowing and so forth. All of the legislation we can support—and I think the chairman of this committee has done a fine job—we will not be able to do the job at all because interest rates will kill you.

Dr. RIEDY. Most of the groups represented at this table, I believe, signed a letter to the President indicating our support for his approach to solving the problem of inflation, but urging him to stick with his commitment to a \$42.5 billion maximum deficit for the upcoming fiscal year and taking whatever steps are necessary to achieve that, so that we do not crucify ourselves on higher interest rates. I think most of the people would agree with that.

The CHAIRMAN. If the Senator would yield, let me make a comment. That might be fine, but a \$42.5 billion budget deficit next year is impossible. There is nothing—I just want to make sure you

understand that. It may be a goal, though, with what has happened to the interest rate rollover and the increase of interest. There is nothing that we can do to reach a \$42.5 billion budget deficit next year unless you want a massive tax increase.

Dr. RIEDY. The kicker was that we agree, if necessary, that a deferral of the income tax cuts should be considered. Now, granted, that is 1982 and 1983. The problems we are facing today are the result of lagged effects of prior policies over the last couple of years.

Mr. MASTERTON. I would like to address that in brief, if I might. I think the conclusion is that high interest rates are killing us. High interest rates are driving thrift institutions to the brink. We are in the worst state of affairs we have been in for 50 years. At the same time, the Depository Institution Deregulation Commission is moving even more aggressively to burden our institutions which are in a sorry state, with liability or deposit deregulation that do nothing more than increase the costs of deposits, maintaining our deposits and, I would submit have little benefit to the small depositor.

The small depositor, would be best served by seeing a sound economy and sound, stable financial institutions. That is why we felt it was critical in our testimony today to urge you to consider simultaneously the issues as partners, that of deregulation and expansion of powers.

I hear my good friends in the realtor and homebuilding fields say you cannot have these new powers, you will hurt me. What help am I giving them now? What can we give them as weak institutions, unable to compete in this broad market? I spoke, Senator Garn, to one of our leading regulators in this country at a brief meeting the other day and I said, Mr. Chairman, would you talk for a minute? I am going to be before Senator Garn's committee next week. Will you tell me about what you think about powers for thrift institutions, broadened powers?

He sat back and gave me a description of a thrift institution that you went to to get your home mortgage or you went in every week and put your \$2 in, you put your school savings in. And finally I said, Mr. Chairman, that is out of a painting by Norman Rockwell. That is the days when Sears, Roebuck sold clothes and hardware. That's not today. Today Sears, Roebuck owns the biggest real estate firm in the country, and you're putting us in a corner and saying everybody else is going to have those powers. But you guys; you have to wait, you are not ready. You cannot cover the costs of this.

How many groups in America have heard before, you are not ready to take on those powers? I know we cannot take on, toe-to-toe, money market funds today. We have been before the Congress over and over again. Senator Proxmire knows that we came before him over and over again about this so-called level playing field—someday than ought to outlaw that phrase from the American language—saying let's level it with us; let's give them reserve requirements.

Last week, 2 weeks ago, they went up \$2.5 billion when we were supposed to have our great benefit from the all-savers plan. They are the guys who are going to get the profit benefits out of that

thing. If you look into those benefits, what fees they are getting for placing their funds with the thrift institutions, it will be shocking when the year is over.

I agree with you, Senator. These interest rates are killing us. But we have got to look at the problems simultaneously this time, we must slow down the pace of deregulation that is putting us right to the wall. We did not create these rates. We have got to have some relief. But we have also got to have the powers to deal with the next cycle, the future conditions, so that we can provide those homes that John Wood wants for his people. We would like nothing better.

Senator PROXMIRE. Mr. Brooks has a comment he would like to make. I hope I have a chance for a question after that.

Mr. BROOKS. I will be brief, Senator Proxmire. I certainly agree with you 100 percent on the high interest rates and what the ramifications will be if they do not come down. The DIDC has rescinded its action, as you know, on the passbook increase. They have deferred it. The Treasury Secretary wanted a 150-basis-point increase, then decided on 50, and now he is saying maybe that is not necessary. But there are two other actions taken that really will keep interest rates up, will keep costs up, as far as home buying is concerned. One is IRA/Keogh, which is a ceiling free, wild card account which takes effect on December 1. If you remember the wildcard experience we had back in 1973, this one will make that one look like a picnic. We will have people playing musical chairs switching IRA/Keogh accounts all over the place. That's the first action. Then there is the 4 weeks averaging that they put on the 6-month money market certificate, so that when rates come down, the moving average will keep rates higher. I just cannot reconcile the high interest rate problem we have with the DIDC trying to keep interest rates up on the home buying in America.

Senator PROXMIRE. Mr. Coles, I would like to ask you to respond to what I think was a very helpful analysis by Mr. Wood when he put together the various actions that have been taken, some addressed already by Mr. Masterton, but the actions that have been taken to try to help the savings and loan industry. And then I would like to ask, in connection with the objections that Regan said yesterday, Mr. Wood said that this means money to the all savers amortizing losses from the overall yield, thrift access to the Federal Reserve discount window, and most importantly of all, the instrument of future transactions adjustable rate mortgages.

BENEFITS OF EXPANSION POWERS STILL YEARS AWAY

Yesterday it was pointed out by the commercial banking industry, and the day before by Treasury Secretary Regan, that the expansion of powers for the S. & L.'s would not be helpful for years to come because you cannot have the expertise now. One witness indicated that he had an S. & L. competitor that had 20 employees. He has 100 employees. He said the asset size is the same. He has a more complex operation. He said if you train loan officers, expert personnel, bring them in, it is going to be a long learning process. Meanwhile, you will make mistakes. You will have difficulties. So he felt that the reliance—let me ask you this way. Should the

reliance be on the package that Mr. Wood has put together so that we can have some expectation that we can have a better concentration in the future on housing by the thrift industry, so that the homeowners and realtors and so forth will not be left out.

Mr. COLES. The powers that have been given to us already, in which Mr. Wood cited, have been helpful but they are incomplete. For example, access to the Federal Reserve discount window. To my knowledge, only one association in the State of Texas has so far been able to gain access to the discount window in our district. The powers that we are supporting in this legislation are supplemental to the powers we currently have and do not necessarily indicate that we are going to move out of the housing industry.

I would like to have Mr. Wood and Mr. Shimberg and their associates as supporters of this legislation, because I recognize that their support is required. We do not have to make a judgment in the absence of evidence of the position of the thrifts that they will stay basically in the housing industry. For example, I can recall back in the mid-1970's a similar confrontation taking place on the granting of additional authorities to Federal associations to make consumer loans. It was the contention of those industries who rely on funds from the thrift associations that, if given power to make consumer loans, we would divert funds out of the housing industry.

Let me cite the example of my State, Texas, where thrift associations have had virtually unlimited powers to make consumer loans for many decades. What we have found is that thrifts have used that to supplement their basic housing lending. Thrifts in Texas, although without restriction, have less than 5 percent of their assets in consumer loans. What we have found through analysis is that associations who have used the consumer lending power have been able to grow more quickly and the net effect of that combined growth is that the funds flowing into housing in the State of Texas have been enhanced rather than reduced by consumer lending powers.

I spent 8 years as a commercial banker and I know through personal experience how different commercial banking is from the savings and loan industry. In our association we have roughly 550 employees. Over 200 of those are directly involved in the origination, sale and administration, servicing of mortgage loans. Those are where our skills are. That is the area in which we expect to continue to focus our activities.

We need these additional powers in that we cannot determine with any certainty what the world will look like in a deregulated liability environment. We will use them as necessary to remain viable, but our commitment to housing as an industry remains unchanged.

The CHAIRMAN. Senator Heinz?

Senator HEINZ. Mr. Chairman, first I would like to ask unanimous consent to put a statement in the record.

[The complete statement follows as though read:]

STATEMENT OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, the devastating effects of high-interest rates on various sectors of the economy have been well documented in the press and in extensive testimony before this

committee. I am very interested in the testimony of the most affected industries, home building, mortgage bankers, realtors and thrifts. These are the backbone of this country's efforts to meet its still unfulfilled housing needs and their plight cannot be neglected without dire consequences.

I would like, for a moment, to concentrate on the plight of the thrifts which have served this Nation well as a traditional conduit for funds between savers and home buyers. In the past year, thrift institutions have experienced one of the worst periods in their history in terms of profitability. The figures are startling. Former FDIC Chairman Irvine Sprague testified that the 79 largest savings banks representing three-fourths of the industry's deposits recorded net losses for the first 5 months of 1981 in excess of \$400 million, portending the worst losses ever for the industry.

If we are going to truly aid the thrifts this committee must address the fundamental issue of the continued long-term viability of the thrift industry. The combination of Federal budgetary constraint and unrelenting market forces leads inevitably to the conclusion that the only meaningful tool available to the thrift industry over the long run is self-help—the means to be independently viable in a continually changing financial and economic environment. The bill I introduced yesterday, the Savings Bank Act of 1981, S. 1752, is designed to accomplish this for savings banks.

Under the Deregulation Act of last year, it is now public policy that regulation Q limitations on rates on consumer savings deposits are to be phased out. On August 1, 1981, rate limitations on certificates of deposit of 4 years or more were eliminated. In succeeding years, certificates of deposits with progressively shorter maturities can be offered at unregulated rates. Moreover, the quarter-percent rate differential available to thrift institutions on most certificates of deposit is scheduled to expire in just 2 years.

For years regulation Q was a cornerstone of U.S. housing policy. Under that regulation the existence of institutions devoted to the creation of housing was fostered by the existence of the quarter-percent rate differential which was tied to limitations on the use of the institutions. Like regulation Q, the new All Savers Act seeks to direct flow of funds into the residential mortgage market. But unlike regulation Q, the All Savers Act does not differentiate between commercial banks and thrift institutions. The All Savers Act is designed to assure a flow of lower cost funds into housing through banks and thrift institutions alike, and we will be monitoring its performance carefully.

To the extent that Congress adopts programs encouraging flow of funds into housing, with commercial banks and thrift institutions given equal opportunities to participate, a policy restricting thrift institution investments can no longer be justified.

Treasury Secretary Donald T. Regan told the Senate Banking Committee on April 28, 1981:

It seems that at some point all the institutions must have the same powers to perform the same types of business. The current problems facing thrift institutions are largely the result of prior government attempts to structure an industry by statute in ways that are not economically feasible. We believe all depository institutions should have equal powers and should be free to choose whatever specialization they wish based on their individual competitive skills and goals. The ultimate beneficiary of this flexibility would be the consumer. Whether or not one believes

that there can or should be a totally "legal playing field", clearly we are and should be moving in that direction and away from counter-productive financial balkanization.

Commercial banks with their shorter term, rate sensitive asset structure are much better able to adjust to changing conditions than are thrift institutions with their long-term investments in the Nation's housing. Unless thrift institutions can begin making a broader range of profitable, interest-sensitive loans, these institutions will be unable to survive the consequences of deregulation of the cost of their funds.

I recognize the concerns expressed regarding the impact of broadening the powers of thrifts on their traditional commitment to housing finance. If one fundamental lesson has been learned in the past few years it is that narrowly confining thrift institutions to residential mortgage investments in periods of rising interest rates jeopardizes their very existence and thereby does not assure an adequate supply of mortgage financing.

Housing does remain an important national priority and assuring an adequate flow of funds for housing is an objective that all Members of the Congress share.

It would be unrealistic to anticipate that the thrift industry's deep-rooted expertise in this area will be substantially diverted. Indeed, one of the principal thrusts of broadening their powers is to enable thrift institutions to pursue their housing orientation viably. Further, as long as we maintain section 593 tax treatment eligibility as it is today, thrifts, will have a powerful incentive to remain America's residential home finance specialists.

For the reasons I have already stated I support the concept of broadened powers for all thrift institutions. I intend to work closely with the sponsors of similar legislation. The bill I introduced yesterday, S. 1752, however duplicative in some respects, underscores the degree of urgency with which I view the enactment of changes needed to preserve the viability of thrift institutions generally and of mutual savings banks in particular. It is my hope that the Senate Banking Committee will move quickly and accordingly.

Senator HEINZ [continuing]. We are delighted to have such a distinguished group of witnesses. I have two questions. First, I listened with interest to Senator Garn's question about money market funds and why they were not singled out for special excoriation this morning. Maybe you felt that you had done so earlier.

I would ask you this. One of the things proposed in Senator Garn's bill is mutual fund authority for commercial banks, the ability of those banks to form money market funds whether or not—I guess that is all depository institutions—do you believe the kind of going national with money market funds is going to help or hurt the thrifts? Let me ask that question first.

Mr. MASTERTON. I will respond in general. My personal belief is that the net result will likely hurt them. I think the public sees a transaction with a thrift as a secured deposit type transaction. But I think it will hurt, to the extent that it will escalate the cost. I think the experience with consumer repos evidences that the consumer sees it as a deposit regardless whether it is insured. In general, it will escalate those costs. It will perhaps introduce more volatility in costs.

EXPANSION POWERS GRANTED TO ALL

On the other hand, it will introduce some stability as far as liquidity is concerned. Our feeling predominantly is it is not a power that we have on top of our agenda as a seek item. However, if in the wisdom of this committee and the Congress, it is a power that is to be granted to one type of financial institution, it should be granted to all.

Senator HEINZ. You are not seeking it, but if it is granted, on the condition that it is granted to all, you would not oppose that?

Mr. MASTERTON. We would say it should be granted to all. We would not oppose its being granted to all.

Mr. COLES. May I add something to that? And I look at it from a somewhat different perspective. We do support the authority for savings and loans to offer collective agency accounts. In contrast to what might have been said earlier, these funds would not be commingled with our general corporate funds. And we would operate it as a mutual fund. Our belief is that this service has proved very attractive to investors.

We see no reason why we as thrift institutions should not be able to continue to have our customers come to us for that very important investor service. I think the money market funds will diminish in attractiveness as interest rates turn downward. We think this is one way of continuing that customer franchise.

Mr. WOOD. I would like to comment on that.

Senator HEINZ. Now that we have heard from the thrifts, we will turn to the homebuilders and the realtors.

Mr. SHIMBERG. There is \$250 billion in round figures in money market mutual funds, if I remember the last figure I saw—excuse me, \$165 billion. As far as I know, not one cent of that has anything to do with residential mortgages or mortgage finance.

Now, it is \$165 billion, and it has been very well promoted by E. F. Hutton, Merrill Lynch, and all the brokerage firms. If now it is promoted by every commercial bank and every savings and loan association in the United States, I guess it is reasonable to assume that the figure will grow from \$165 billion to a substantially higher figure.

From the point of view of an adequate flow of mortgage money into the housing market, I cannot see how that can do anything but hurt us.

Senator HEINZ. Would anybody disagree with that?

[No response.]

Senator HEINZ. I guess not.

Mr. WOOD. One point.

Senator HEINZ. The record will show that nobody even moved.

Mr. WOOD. Philosophically, there is a real danger in letting a federally chartered institution get into any area that they would like to, because it is a good consumer item. For instance, that would mean entering into the real estate business. They are chartered in our areas to withdraw funds from our community, insured by the Federal Government, and then use that money to compete against us. We think this is anticompetitive and poses a danger to all small businessmen.

We also see that with the all savers certificate, money coming in at 12.6 percent—and the adjustable rate mortgage now in place—I

only saw one bank announce 14-percent mortgages on the day of that happening. I know it is only 3 weeks. We don't see any big loans being made into the real estate area. It's going to other areas, apparently.

Mr. COLES. I might take exception to Mr. Shimberg's comments, in that we believe that the collective agency account need not necessarily be invested in all short-term investments. If we, through control of inflation, see a return to the normally sloping yield curve, we would expect that that agency relationship could be used to put funds in longer term mortgages. We are not talking strictly about the kinds of money market mutual fund as it exists today.

Senator HEINZ. One thing I would just like to clarify. Let me ask Mr. Brooks. Your opening statement had very few kind words for the DIDC, as I read it, a bare minimum, as we say around here.

Why, if you believe that raising passbooks a half a percent is going to be extremely costly to your industry, would the broad availability of mutual money market funds not achieve indirectly what the DIDC, until they backed off, threatened to achieve directly, which is just narrowing or making more negative your spread?

Mr. BROOKS. As far as the increase in the passbook, of course, it would not do any good, because it is still so far below the market rate, as we know, and it would cost us roughly \$500 million, half a billion, for every half point.

Getting to the issuance of money market mutual funds, the U.S. league has not had time to take a position on this. I have some concern about it because of the fear that money might move internally out of other deposits and into such money market mutual funds. And it would certainly, I think, increase our costs; there is no question about it. I think probably it would tend to keep some money from the housing industry. It is one thing to shift out of the institution, and too much of that has been done, but if you have it in the same institution, that causes me some concern about it.

Senator HEINZ. One last question, which has to do with really the much broader issue of interest rates. We all are very concerned about high interest rates. They have a particular effect on the realtors and the homebuilders who are here today. They have caused tremendous financial difficulties for the thrifts, and also for some of the smaller commercial banks that are more into longer term mortgages than the bigger banks. They certainly are a contributing factor to the recession we are now in. They are obviously causing a great many people a great deal of pain.

You do not have to be any kind of an economic genius to realize that forcing people into bankruptcy—whether they are small businessmen, or realtors, or homebuilders—is not going to make this economy stronger in the long run. Nobody benefits from bankruptcies. All of that is self-evident.

SHOULD FED RELAX THE MONEY SUPPLY?

What is less evident is what alternatives we have that will bring us to a good climate of economic growth over the longer term. I really want to ask two questions in that regard. No. 1 is that if the Fed were to relax the money supply, moving toward upper ranges, 1-B, for example, there are those who would say if the Fed does

that you might get a little brief, temporary relief, kind of like Alka-Seltzer, fizzing until it stops, in the short-term rates. But you would have an offset in the long-term rates.

People would view that as the Fed giving up on the fight against inflation. People would be even ultimately more crowded out of the bond market, and into the short-term market, and you might have a little bit, but you would be worse off than before.

Do you agree or disagree with that?

Mr. WOOD. To respond—

Senator HEINZ. Jump in where angels fear to tread.

Mr. WOOD. We have gone in to see Chairman Volcker, and we think a slight massaging would not cause that effect. The Fed is well below the M1B targets, but we think if they massaged it very much, that could well be the effect, but if it was a slight massaging it would be helpful. They reduced the surtax by 1 percentage point, I believe, last week, or the week before last. If they reduced it even further, that helps. We urge 1-to-2 percent increase in the supply—which we do not think would have a negative impact on the economy.

We think it is kind of odd for us to be coming in here and saying that we want to deregulate, and at the same time saying let's have a Federal preemption which regulates, and not letting all of these programs that we have put into place have time to work such as the all savers certificate. If we let them get into other areas—

Mr. MASTERTON. Our industry has been and remains on record in support of the thrust of the administration to keep responsible monetary policy and fiscal policy working in tandem. We have not changed that policy. We are not seeking abandonment of monetary controls.

I think many can visualize what you are describing as a likely result of loosening of monetary policy. I can say that with my full background of economics 1 in my early years in school. We all can be experts.

Senator HEINZ. There are times when I felt like I took economics 1 for several years, as well.

Mr. MASTERTON. We are all taking it right now, I think, daily.

But our feeling is we are willing to do our part and tighten the belt, and tighten it, and tighten it, and stay in there. We are looking for the long-term benefit, and not a short-term fix.

Getting back to our initial premise, if that is the case and if high interest rates are part of the overall governmental policy, and we understand the reasonableness of that within the logic of monetary controls, then consideration should be given to the rate at which deregulation on interest rate ceilings and other controls come about through the actions of DIDC. We would say that those two actions are inconsistent—totally inconsistent. The net result is proving, as Senator Proxmire said, to kill us.

Senator HEINZ. I want to hear from the homebuilders. I have the feeling they may be a little less enthusiastic.

Mr. SHIMBERG. About what?

Senator HEINZ. About the policy just described.

Mr. SHIMBERG. The policy of going toward the higher limits of the—

Senator HEINZ. The philosophy behind the Fed's policies of monetary restraint.

Mr. SHIMBERG. The homebuilders over the years, as I think you know, have had some problems from time to time with the Fed's policy. It is not only this time. We have centered in on that in the past. I think we may have a different situation today. I personally believe that if there is indication that the Fed is going to loosen up, I think that that may make interest rates go up, rather than go down, certainly in the long term.

I have to say, though, Senator, we, as has been brought out, the homebuilders are supporting the administration's program. It is obvious that the effect of what is happening today, which was not brought about by this administration or any specific administration, has been developing for years. It is falling most heavily on the housing industry.

The housing industry is close to being finished. If the present situation continues for another year, it may be that there may not be so many candidates on behalf of the National Association of Home Builders to come here and testify. It is a very difficult situation.

I talk to people every day—not homebuilders, but particularly young people who want to buy houses. It is very hard to explain this situation to them. The cost of housing is totally beyond their ability. We are only asking that while trying to restructure financial institutions, you give some thought to where an adequate source of mortgage finance is going to come from in the future. We still sincerely believe that housing is a necessity, not a luxury.

Senator HEINZ. Let me go—you want to ask that question. It looks like we are debating economic policy, when we are holding hearings on yours and other people's legislation, but we all recognize the dynamism that is taking place in our economy, and the interest rate volatility might be a better word for it, but we have a number of very sweeping proposals, not just yours, Mr. Chairman. I understand your motivations and purposes in introducing a very large and comprehensive bill. I salute those purposes and motivations.

But I think we should bear in mind that it is equally possible for us to overreact to circumstances that seem catastrophic, prevalent, pessimistic, today.

The CHAIRMAN. Congress usually overreacts to everything, or underreacts. We never seem to do it quite right.

Senator HEINZ. If you are a public official, Mr. Chairman, and you have been in the job for a short time, and they say you have been there just a short time, you don't know anything—but just after that you have been there too long and it is time for a change. We never get it right.

But apart from that, and quite seriously, I think we have to recognize that the financial structure that we have has been around for awhile. By and large, it has served us rather well over the last 40 or 50 years. To a certain extent, every time we make some dramatic change, we find that we have to make some other dramatic changes, and there are times when we would be well advised just to step back a little bit and make sure that we are not,

as we strike blows in various directions, hammering the entire system out of shape.

The CHAIRMAN. Senator Sarbanes?

Senator SARBANES. Thank you, Mr. Chairman. The first item has provoked me to make a comment at the outset, and that is the extent to which I think people are getting themselves into an absolute Catch-22 situation on what the Fed should do on the money supply as it relates to the interest rates.

On the one hand, we are being told that interest rates result from supply and demand; money is a commodity. That would lead to the analysis that if they added to the money supply, came closer to their target—you are not even asking them to exceed them—that that would help to get interest rates down. And then people come along and say if they do that we are going to have an expectations theory at work, and interest rates are going to go up.

So you end up saying there is really nothing you can do. If they add to the money supply, which, on the traditional analysis, would help to ease the interest rates—no, no, that's not what is going to happen. The interest rates are in fact going to go up. Well, you know the logic of that is that they ought to tighten the money supply, in which case the interest rates will go down. We live in an Alice in Wonderland world in this analysis. In the meantime, economic enterprises which have been enormously productive and longstanding in the society are just going by the board.

I am not talking about marginal activities. That would be a different proposition. If you could look people right in the eye and say, "Well, you were undercapitalized, you really were not a very efficient operator. We have talked to everyone else in your industry"—homebuilding, or realtors, or auto dealers, or small business—"and they all say, well, you're a nice fellow, but you were not really very effective, and you were not very productive, and, you know, we have a competitive system here, and if you cannot hack it, you are going to go by the boards."

That's one thing. That is not the people you are talking to now. You are talking to people who say: Look, we are the third generation in our family in this business. We won awards last year and 2 years before that and 5 years before that, as the best dealer, the best operator, the best homebuilder. And we cannot cope with the situation.

When this committee made its second monetary policy report for 1981 last month, five of us entered additional views, and I commend them to the members of the panel if you have not had a chance to see them, in the course of which, to address the question that Senator Heinz was putting at the end, he made the point that I believe very strongly that the continuing high interest rates are working at cross purposes with efforts to build a stronger and more productive economy.

First of all, ostensibly designed to check inflation, they become an important contributing factor to inflation. It is reflected in the housing costs. All of this creative financing that you use is invariably reflected in the price of the house. You just charge more money because you can run some good financing terms with it. Farmers and small businessmen have no choice but to pass on the high cost of credit.

Second, in two respects the high interest rates are an obstacle to efforts to reduce the Federal debt. They obviously increase the carrying charge on the existing debt. The \$16 billion in additional revenues, additional revenues and reduced spending that the administration is now seeking, is by coincidence almost the exact equivalent of the additional carrying charge on the Federal debt from the forecast which the administration made at the beginning of last winter, which has now been revised twice.

The high interest rates are provoking a near depression in certain sectors of the economy, causing workers to be laid off, with the result that they cease to be taxpayers and instead they sit idle and begin drawing unemployment or other support payments out of the Treasury. So you have a double impact on the Federal deficit. You lose revenues and you increase expenditures automatically.

It is my own very strong view that the Fed could, in fact, ease its policy somewhat. I see the Secretary of the Treasury is finally coming around to that position to some extent. The Fed was not even reaching its own monetary targets and getting these rates down to a more reasonable level where people can function with them.

On the issue that is before us, I want to really come at you with probably what would be perceived to be more philosophical or general questions, but I think that we need to do that.

I had grave misgivings about the legislation enacted, 2 years ago I guess it is now. The more I watch this unfold, the more convinced I become that I am really a very prudent and conservative person. I really have a lot of questions about radical shifts from existing arrangements unless we have a better feel for what that is going to result in.

Let me ask you this question, gentlemen, Did the previous legislation work as you expected, Depository Institutions Deregulation Act?

Mr. BROOKS. I would like to respond to that, Senator.

No, it did not. As I understand it, we were supposed to be given 6 years for deregulation, and the DIDC on May 28, 1980, did not take 6 years, did not take 6 months, did not even take 60 days to deregulate a large portion of our deposits.

MORATORIUM REQUESTED

I was interested in your discussion on interest rates, because certainly the DIDC is exacerbating that problem. As a matter of fact, when interest rates generally start to come down, DIDC actions will tend to keep them up since as far as these deposit costs are concerned, they must be passed on to borrowers.

I likened it to the fact that where we are bleeding to death—and I say “we”—we are referring to all of the housing-related institutions—we are bleeding to death due to high interest rates. The DIDC has activated a pump, and they are trying to suck the blood out much faster and for a longer period of time.

I just cannot believe that this Congress intended that the DIDC should follow this practice or this procedure. And yet the worse the situation gets in the savings and loan business, with 30 percent in the red in June and now over 70 percent in the red, they take action which becomes more and more and more onerous. It certain-

ly has not worked, in my humble opinion, as to what you, the Congress, the House of Representatives, and the Senate of the United States, intended. That is why we are asking for a moratorium, Senator. It is time for a "time out" on this whole thing until we can get this interest rate situation under control.

Mr. MASTERTON. I would second those comments and add to them. We supported the act in 1980 which created DIDC. We still support the concept of orderly, balanced deregulation, but we thought there would be three elements that would come out of that law. One would be a balance of powers that would be added, and that is what we are addressing in these several bills today. Second would be the question of orderly deregulation. And the third would be the question of safety and soundness.

We are concerned about what DIDC has become. It has five members. One represents the credit unions, which are not regulated under any of the acts of DIDC. A fifth, who is the chairman currently, is Secretary of the Treasury. We think that there is a conflict there between executive branch policies and programs and the responsibilities of the three primary regulators of the financial institutions. We think it is an imbalance that we did not anticipate.

The issue of deregulation, orderly deregulation, is proceeding without logic. For example, if I could just give you this one simple quote, Senator, without taking too much time. This came out of the meeting of September 22, on the public record, the comments of Chairman Volcker, who voted in the minority on the 3-to-2 vote to increase rates, and he says:

I do think our injunction to have due regard for safety and soundness of the depository institutions is relevant and important. In this case, all of the analysis that I have suggests there would be a very substantial turning cost to the thrift institutions and commercial banks. The impact on earnings seems so severe in the situation in which the safety and soundness of these institutions would be jeopardized. I am forced to arrive at the conclusion that we ought to keep this on the agenda continuously, but not act today.

And by a 3-to-2 vote, two of those votes being Secretary of the Treasury and one being the head of the credit union, not affected by it, that order passed, in spite of the admonitions of the Chairman of the Federal Reserve that this was a safety and soundness issue.

In answer to your question, Senator, we believe it has not behaved in the manner in which we expected when we supported that act, and we think it should be changed.

Senator SARBANES. Let me ask you this broader question. The premise is that everyone is going to be put on the level playing field. I have heard that concept sort of added up, added back.

What is going to be the consequences, you look ahead of everyone being put on the "same level playing field," particularly what will the consequences be for the concentration of financial and economic power in this country?

Mr. MASTERTON. May I answer that?

Senator SARBANES. Sure.

Mr. MASTERTON. Our industry does not view complete homogenization of institutions as the net result of the combination of whatever will come out of the various bills that are before you. Our preference is to see a specialization by choice. We have many

institutions in our industry that prefer to be predominantly mortgage banking type institutions. In fact, some are associate members of the mortgage bankers and gravitate in that direction.

Senator **SARBANES**. But if you put it on a choice basis, there are some who may choose to be everywhere. They are all on the same playing field.

INTERSTATE ACTIVITY OF FINANCIAL INSTITUTIONS

Let me ask you this question. What is your view on the interstate activity of financial institutions?

Mr. **MASTERTON**. Our position has predominantly been in response to the issues raised in the regulators' bill, which we think should be very carefully reviewed relative to the concept of going interstate versus merger—

Senator **SARBANES**. You are going to get salami'd here. Let's look ahead. I am trying to look ahead. What is your view on all being on the same level playing field and then that playing field being nationwide? What is going to be the result of that? What kind of structure of financial institutions are we going to have?

Are you gentlemen familiar with the speeches of Secretary of the Treasury **Regan** that he has given on occasion in recent times which seem to carry with them the fairly clear implication that it does not really much matter whether there is an S. & L. industry in this country or independent banks?

Perhaps where we are going is there is going to be a **Merrill Lynch**, 10 or 15 or comparable aggregations. And that is the Nation's financial institutions. Is that a prospect that may be in the offing?

Mr. **MASTERTON**. It is if you pursue the comments that you quoted.

Senator **SARBANES**. May I hear from other members of the panel.

Mr. **MASTERTON**. It is not our desire.

Senator **SARBANES**. I understand that. But you get into a limited box, a limited perspective, and you say we have problems, let's do this and let's do that. That may all be leading both you and the Nation down a path, when we finally turn around and look at where we are, we are on this level playing field, nationwide in scope.

And you say, "Well, we will specialize by choice."

And some of the players will come out on the playing field and say, "We do not want to specialize by choice. We just want to have the whole playing field if we can get it."

And then you say, "Well, that's competition at work."

Well, yes and no, it depends. There are other important objectives that we have been trying to achieve through the nature of our laws, some dealing with a concentration of economic power, some dealing with a focus on providing shelter for the American people, fundamental necessity.

I submit to you gentlemen, if we end up with a financial structure that is not much interested in providing shelter for the American people, I do not think the American people are simply going to say, "Well, we will do without shelter because the financial structure is going elsewhere." The American people are going to want some solution to the problem of how they are going to get shelter,

either through rearrangement of the private sector or by going to the public sector. In fact, the latter is happening to a considerable extent now. That is why you are getting all of these States and municipalities going into the market with their bonds.

Mr. BROOKS. Senator, in response to your question as to where we stand on the interstate issue, the United States League would hope that these merger problems could be solved within the State and among thrifts. If they cannot be, then we would hope that it would be kept to a minimum and that supervisory mergers be restricted to thrifts with thrifts across State lines, so that the thrifts' functions would be maintained.

We are opposed to the so-called interindustry merger. We believe we would end up with a relatively few large banks, and that does not work to the good of the people of this country.

I could not agree with you more about the housing situation, and I feel the people of America are about ready to speak on this issue, because we are running about 1 million units behind in construction every year, and we are not meeting those needs. And I think that the people will speak out on that.

You know, I am curious. You are talking about the level playing field. The banks say that, and I believe—and I am not sure, but the chairman of the DIDC the other day, the current chairman, talks about a level playing field. And yet, when it comes down to some powers that we need to survive to continue our housing activity, he says, "No, we are not ready for that level playing field in that particular direction." I just do not understand that line of reasoning myself. And I really think we will have a concentration of power, if we go to the interindustry merger question.

Dr. RIEDY. Your question was really phrased, I think, in terms of the form of ownership of the institutions in terms of the concentration of power. If I can speak to your question from the perspective of the mortgage banking industry, which is an interstate industry—a lot of our companies have offices in many, many States across the country—the competitive pressure today and inflation are hastening the evolution in the business.

That happened one other time, when the mortgage banking industry looked very attractive to commercial banks, and bank holding companies across the country acquired very quickly a large part of the mortgage banking industry. And that has worked out quite successfully in terms of the function of mortgage banking, staying within the subsidiary and serving today about 25 percent of the country's homebuyers.

I think we have to distinguish between the functions that are involved in a holding company structure, whether it is Sears, Merrill Lynch or whoever, and the concentration of power that probably is an antitrust question within that type of an operation. I am not saying we should get rid of specialized savings and loans, but they may exist in a Sears holding company, which they do already today.

Senator SARBANES. The European countries are characterized by and large by the presence of a few nationwide major financial institutions. That is their structure. It is in marked contrast with the situation in this country.

Another thing that has been in marked contrast is the degree of homeownership here compared with there. There are many people who believe that homeownership is not only an economic issue but a very important social issue that runs to questions of the stability of the society, people's sense of a stake in the society. For the overwhelming percentage of Americans, the one significant investment which they have is their home.

And I do not think that we have been able to encourage that as successfully as we have without relating, at least to some extent, to the financial institutions which have been primarily related to the homebuilding and homeownership industries.

We had a hearing here of where the money goes, a drawing of where the money goes that is buying pulled out of the country into the money market funds. Where is it invested? I can tell you it is not being invested back in homebuilding, homeownership, that's for sure. It is being pulled out all over the country, and it is being brought into the major money market centers. It is being put in the CD's of the leading corporations. A good part of it is going abroad then. It is seeking the immediate highest return, the immediate highest return, which you know, from the individual's point of view, they would say that's what we have got to seek. But from the overall social point of view, what is the money being put into? What does that mean in terms of building the economic and social base of the country?

I have gotten my second note that my time has expired.

Gentlemen, I would like to say that I think that we need to start thinking about—in broader terms—about where some of these things are leading us to, and what kind of society, economic and social consequences will flow from changes which, when we see them in the narrow perspective, may not be fully appreciated as having these larger implications.

Mr. SHIMBERG. May I make one comment, Mr. Chairman?

The European experience—as I think you probably know, is that in many European countries housing is a government function. The housing is built, provided and allocated by the government.

I hope that we never come to this situation in the United States.

The CHAIRMAN. It is Senator Proxmire's turn.

I would like to comment once again, though, there is no Senator on this committee who feels more strongly against concentrations in a few large institutions. But again, if we do not concentrate on the problem within the traditional depository institutions, while the new boys again run wild, there is where your concentration will be.

The 20 institutions that Senator Sarbanes talks about will not be Chase Manhattan and Citicorp; it will be Sears and it will be Merrill Lynch.

Senator Proxmire?

WHERE IS THE MONEY GOING?

Senator PROXMIRE. To follow up a little bit on Senator Sarbanes' point: Where is this money going?

It seems to me, more than ever before in our history—at least in peacetime—that money is going into Federal securities. We have a trillion dollar national debt. It will be \$1.079 trillion by the end of

the fiscal year. In fact, the Secretary of the Treasury has indicated he will come back not just once, but probably twice, to ask for further increases.

That's why it seems to me that this policy we are following now, of a loose fiscal policy, expansionary fiscal policy, and a tight—very tight—monetary policy, is wrong. I realize that the Federal Reserve has no alternative. And I support Volcker—what he is doing. He is the only game in town fighting inflation.

But we have to get the fiscal policy in order, and until we do, it is just plain murder for you gentlemen.

The CHAIRMAN. If this is a loose fiscal policy, what have we had before?

Senator PROXMIRE. It's about the same. We are going to have about a \$60 billion—

The CHAIRMAN. Which other Congress has cut \$50 billion out of the 1981 and 1982 budget, in any 2-year period?

Senator PROXMIRE. Which Congress has cut taxes but about as much and increased defense spending—so you are exactly where you were before?

You cannot have it both ways. You and I both voted to cut the spending, but we also voted to cut the taxes. It seems to me we either have to cut spending more or restore some of the tax cuts, or recognize that the housing industry is going to continue to be in very great difficulty.

The Chairman. There is no tax cut. There is a decrease in the increase of taxation. That is all that has taken place.

Excuse me. I will be quiet. Go ahead.

Senator PROXMIRE. Let me ask you gentlemen. I realize that you may not all be economists; maybe you are. But it seems to me that we have to take another look at the economic policy. We have always assumed in the past that if we increase Federal spending, not balance the budget, we can increase employment.

The situation is not that way now. We have industries that are so sensitive to high interest rates and the credit policy, and so important for employment in this country, that they are suffering very much and will suffer more if we continue to follow this kind of a policy.

The fact is—and you gentlemen can correct me if I am wrong—every housing start means about 2 man-years of work. We need another million housing starts. We would have the million housing starts if we had a reasonable rate of interest. That would be another 2 million jobs.

In the automobile industry, probably another 400,000 or 500,000 jobs if we had reasonable rates of interest.

We get the rate of interest by following, as I say, a tighter fiscal policy.

I think, for one of the few times in recent history, it is very clear—if you want to expand the economy and provide more jobs, you do it by following a more stringent fiscal policy, not a looser fiscal policy.

May I get a response on that from any of you gentlemen?

Mr. Coles?

Mr. COLES. I would not disagree with that, Senator.

Nominal rates of interest will ultimately reflect real rates of interest. And so, the effort has to be made on the question of inflation. Certainly a stable monetary policy, coupled with a responsible fiscal policy, and factoring in the other things that do affect inflation, will bring real rates of interest down and inflation down. And real rates of interest, added to that, will result in nominal rates of interest which are not excessive.

So, we do support a stable monetary policy, and not one given to fine tuning, as has been the case in the past.

Senator PROXMIRE. Let me get back to the specific legislation that is before us. You recommend direct investment authority in real estate for S. & L.'s.

What about the REIT's experience? Shouldn't we be cautious about that?

And should the authority be limited to housing related to real estate, rather than commercial building?

Mr. COLES. I will respond based on my personal experience.

I was a commercial banker at the time that REIT's once again came into vogue. I saw the unbridled growth of REIT's expanding into marketplaces with which the REIT's were unfamiliar. That led to severe problems in that industry. On the other hand, I have been president of a savings and loan in the State of California and the State of Texas, where direct investment in real estate has been permitted. I have seen that authority used judiciously.

I think, if we are going to remain basically housing specialists—and I think most of us in our industry will—that we will see from time to time changes in our spread income. That is the income derived between the cost of our liabilities and the yield of our assets.

We need additional powers to ameliorate those reductions in spread income that occur. Direct investment in real estate utilizes the skills and expertise that we have in our institutions.

We do support direct investment.

Senator PROXMIRE. Mr. Wood, what is your reaction to that?

Mr. WOOD. We are very concerned about this strict monetary policy that you are talking about. I would like to comment on that if I might. First, the monetary policy.

Senator PROXMIRE. Yes, sir. I wish you would.

Mr. WOOD. We think there are so many of us being killed in this process that there has to be just a little relaxation of the targets. We do believe in what Chairman Volcker is doing. We think stronger policy has to be instituted. In the long run, we think it will benefit us all, but we have urged him to release that just a little bit, and we think that would not hurt the economy that much.

But in the meantime, too many of us are going down the drain. The costs are too high at this point. We are backing his position on that.

Mr. BROOKS. Senator, could I comment on the real estate investment?

We favor it. As Mr. Coles has stated, some States have it. We feel Federal associations should have it. We feel this is another profit center for us; and we are talking about survival. And we talked about that before.

It is a modest authority we are talking about—10 percent of assets. And in the case of my own association and many others I know of, it enables us to go into partnership, if you will, with some of the homebuilders and realtors and others, in developing property on a joint venture basis. And this enhances them. It gives them broader magnitude as far as their investments, and it also brings housing on line which is so badly needed today.

We would hope that this would be put in the bill—that direct real estate investment would be permitted.

Senator PROXMIRE. Go ahead, sir.

Mr. SHIMBERG. With reference to direct investment in real estate, there is a provision in this bill which would expand the percentage of assets that could be put into service corporations. The homebuilding industry has had a very bad experience in general in this area.

We have found in a number of places—and we have set this out in the prepared statement that we submitted to this committee—that in effect this is unfair competition. There are Federals in this country, who through their corporations, make below-market-rate-interest loans only on their projects and discriminate against other people.

Now, if this is the result of more investment in real estate and expansion of the service corporation concept to the Federals—true, it may result in more profit to the thrift industry; but we believe that that profit will be greatly at the cost of the housing industry, and ultimately will not produce better housing in this country.

Senator PROXMIRE. You would want to remove the discriminatory practice and still permit them to invest, as long as it is not—

Mr. SHIMBERG. If you are going to permit this and expand it, then I would certainly hope that you would put some strong language in there which would make it clear that the purpose of this is not the discriminatory kind of action that has occurred in the past.

Senator PROXMIRE. Thank you, sir.

Dr. RIEDY. I would like to react to your comment about public policy.

I, like you, am a former economist. At least we agree with the need to tighten fiscal policy and loosen up monetary policy a little bit as a result. I think the reason is because we realize that the sectors that are being affected most by the very high level of interest rates are those that rely upon consumer credit to finance the transactions—automobiles and housing are prime examples. We have to realize today that consumers cannot out-muscle the Federal Government or large corporations in the credit markets.

We do have a vested interest in bringing down interest rates. At the same time, I think we have to be aware, if we are going to protect housing, that at least we have to remove the impediments in the housing market while we are going through all of these other cross-currents, so that we do not make the problem worse before we have a chance for public policy to work.

Mr. Brooks. Could I make a quick response to Mr. Shimberg?

The way we have viewed our investment in a service corporation is as a supply of lots for the smaller homebuilders, utilizing this money and developing—taking rural land and developing it—into

lots that the homebuilders, who ordinarily could not carry them—or warehousing them for the homebuilders. And it has worked very well for them and for us.

Senator PROXMIRE. My time is up.

Could I ask just one more quick question of Mr. Brooks?

COMMERCIAL LOAN POWER

Mr. Brooks, would you support this legislation if commercial loan power were removed?

Mr. BROOKS. You're asking me, sir?

Senator PROXMIRE. Yes, sir.

Mr. BROOKS. If the commercial loan power were removed; yes. We would still support it.

Again, with the commercial loan power, it would give us an added chance of more profitability, which means that there would be a greater chance of survival; and therefore, we could do our job better and continue to serve homebuilding.

I do not think that it is going to hurt homebuilding at all.

Senator PROXMIRE. Mr. Coles?

Mr. COLES. My position would be exactly the same, Senator.

Senator PROXMIRE. You would still support the legislation?

Mr. COLES. We would prefer to keep the commercial loan powers in there. We are uncertain of the kind of world we would be competing in 2 years out. The commercial lending option is a very important part of this package.

Mr. MASTERTON. Senator, let me just say—in the mutual savings bank industry, we would rank the commercial loan and demand deposit powers as the top priority for industry that comes out of this bill.

The comparison that was given earlier, of the 20-employee savings and loan, is not the typical prototype, I believe, of the savings and loan, and certainly not the savings bank industry. Our average savings bank is \$200 million, \$250 million in size. Many of us are the leading investors in our redevelopment areas. We are the people who work with the builders and developers in carrying that project all the way to fruition.

We have to manage their moneys. We work very closely with them. The commercial lending and demand deposit powers are extremely critical to us, but I would simply say this:

These bills contemplate a new type of institution that is neither a commercial bank nor the historic, totally housing-oriented institutions, but are between the two.

And many of our savings, including many in your State, Senator, are already in this mode. These powers are partially implemented already at the State level; and partially implemented at the Federal level. But we need some extension, and the commercial lending and depository powers we seek lead the pack as far as developing that business.

The CHAIRMAN. Gentlemen, I suppose we could debate general economic policy all day—and I am not a former economist.

I think the world might be better off if all economists were former economists. [Laughter.]

I don't know. But in any event, to get back to some of the specifics of the bill. Some of you have mentioned in your testimony

about the inappropriateness of truth in lending disclosures in real estate lending.

Would any of you gentlemen like to expand in more detail on that?

Mr. WOOD. One comment. The new adjustable rate mortgages and creative financing techniques make it very difficult for our industry, Mr. Chairman, to comply with truth in lending.

We do not believe truth in lending was intended to apply to real estate agents as loan arrangers. And I agree with you on your position on that.

Dr. RIEDY. The mortgage bankers would feel the same way about the impossibility of comparing the adjustable-rate mortgages to a fixed-rate loan. It just doesn't work.

Mr. MASTERTON. Frankly, we think the truth-in-lending has probably gotten its major impact as far as housing is concerned, and home financing. And we question whether it still has any great benefit to the public. In the installment area, it probably has some lingering benefits; in the housing area, we doubt it.

We would just as soon see it dropped as far as everyone is concerned.

However, if we are subject to it, and if in fact over 50 percent of the deals that are being made by the realtors today are under creative finance, it should apply to both.

If the consumers be protected, and the realtors want to be in the finance business, the same rules should apply to them.

ELIMINATE TRUTH IN LENDING

The CHAIRMAN. Let me ask you this: Short of totally eliminating truth in lending for real estate procedures, what type of appropriate disclosures would you or could you suggest, rather than using the same type of disclosures on all types of lending, which obviously is very cumbersome, particularly as you get into all of these different types of new creative financing instruments?

Do you just simply want it eliminated, or can you suggest some specific disclosures that would be helpful?

Dr. RIEDY. I think we would prefer to have it eliminated. Our experience has shown that what consumers want is simply the monthly payment, in particular, and the costs involved in the closing settlement. With an ARM that will change after 3 years, there is no way you can give enough examples of what will change, too. Even if it is capped, the most you can say is it will not go more than that much higher or lower.

The CHAIRMAN. If you have total elimination, what types of protections do you have for the consumer? I realize the difficulty. I understand what you are saying. But I am talking about going from one extreme to a disclosure that is so complicated it means nothing, to no disclosure at all. Is there some middle ground?

Mr. BROOKS. I might say, Mr. Chairman, as you know, the savings and loan associations as well as the banks are examined periodically. They look at all of our mortgage loan files. It is all laid out for them. I think that, by itself would do a lot to make sure that the consumer got, shall we say, a reasonable deal—a fair deal, if you will.

The CHAIRMAN. Any other comments on truth in lending?

S. 1720 would remove the volume limitations on old loans, purchases by FNMA and FHLMC. Mortgage bankers have expressed concern that the conversion of these old mortgages into highly liquid mortgage backed securities coupled with proposed changes to the accounting rules for losses for thrift institutions could prompt a massive sale of the certificates when interest rates moderate. Such a sale would force mortgage interest rates up prematurely, as suggested by the mortgage bankers.

I would like your opinions on the statement of the mortgage bankers in this area.

Mr. COLES. We would disagree with that position. We think the marketplace will exercise a discipline over the number of older mortgages or FHLMC or FNMA certificates that are sold into it. The powers are certainly important for FHLMC and FNMA in that the certificates that they will be issuing to our institutions are more liquid, are acceptable investments to a broader array of investors. We think that this will ultimately mean accessing funds that are not currently available to our institutions. And those funds will flow back into housing.

I would like to add at this point, Mr. Chairman, that the National League supports the broader rechartering legislation, proposed by FHLMC. We look forward to the introduction of this bill and urge you to hold hearings on it as soon as possible.

The CHAIRMAN. Mr. Brooks, do you have any comment?

Mr. BROOKS. Very succinctly, I think this would follow the purpose of many of the other provisions of this bill, to keep the S. & L. business more viable. In my case, it would help us get rid of these low yielding mortgages so we could turn around and invest in new mortgages. I do not see how it could hurt us.

Mr. MASTERTON. Senator, I think you can be assured as the rates dropped, our banks will be seeking every opportunity to dispose of existing loans, service them, and roll those dollars over into new activities. The use of the certificate form facilitates this. Plus it gives us an excellent vehicle to use as support for consumer repurchase agreements and other sales to the general public of portions of our portfolio. It is a very constructive move. As far as its effect on the market, I think, on either side of that argument it would be purely speculative.

The CHAIRMAN. Would you consider supporting the purchase limitation on a 1-year basis?

Mr. MASTERTON. Could you define that better, Senator?

The CHAIRMAN. Just waive the purchase limitations for 1 year.

Mr. MASTERTON. I cannot comment at this time. I have to evaluate that in more depth.

The CHAIRMAN. Do you have any comments on the temporary waiver?

Mr. BROOKS. If you put it in and it caused a lot of problems, of course, the Congress can always reverse itself. I cannot see why you should put it on a 1-year basis.

Mr. MASTERTON. I think, frankly, if there is that much of a problem with it, let's get started. I think the 1-year limitation on the aging of assets is, I think, archaic. You have got seasoned loans on the books which are much better security. Let's get started with it. I think if we wait until everything is ready to go, and perfect

and in place, we will all be back here at the next cycle of the economy saying, "We need some more powers for the thrifts." We would rather just get moving.

Dr. RIEDY. I don't want equal time with all of these gentlemen, but I would like to explain the Mortgage Bankers position. We understand the need for certain expedients today to help out the thrift institutions in particular. And that is why we propose the 1-year waiver. But the original language creating the FHLMC and granting FNMA authority to purchase conventional loans specifically said that their purchases of conventional loans were geared toward the bringing of additional money into the mortgage markets.

If we are going to change their major role in the market, then we feel we should talk about that. And the way to do that more extensively than we are doing here as sort of an add-on to the legislation, in a way—is to have separate hearings and concentrate on that issue. But rather than wait for that to occur, the 1-year waiver lets us get started, frees it up and lets Congress look at it again, a year later. We know that there is a need for help right now.

The CHAIRMAN. Thank you.

Gentlemen, I have additional questions of a detailed, technical nature that I would like to submit to you for your response in writing.

Senator Sarbanes, do you have additional questions you would like to ask? I would like to close the hearing by noon.

Senator SARBANES. I have just a few, Mr. Chairman. I will not take very long.

SEARS AND ROEBUCK SAVINGS & LOAN DIVISION

I did not follow up on a comment that you made, Mr. Riedy. We were discussing the level playing field, and the possibility of concentration of powers. As I understood it, you took the view that if Sears, Roebuck were in there that they in effect would have an S. & L. division of the Sears, Roebuck financial conglomerate, and therefore, they would be paying attention to the traditional concerns of S. & L.'s through their "Sears, Roebuck S. & L. Division." Is that your point?

Dr. RIEDY. That would be their internal management point of view, and of course the S. & L. then would be operating—competing with other S. & L.-type institutions, which, granted, are evolving. Sears would then have to choose between, say, a bank, commercial bank as we know it today, and an S. & L. as we know it today, in terms of where it would allocate its resources in competing in the market.

Senator SARBANES. The decisions for the S. & L. division, though, would be made centrally at the Sears, Roebuck headquarters, and not by—in the board rooms of the S. & L.'s across the country; would that be correct?

Dr. RIEDY. I respectfully would not agree with that. I think the function of the savings and loan, whatever it turns out to be, will have to be made close to the action by the management of that savings and loan. They have to report to the board at Sears, grant-

ed, as will every other affiliate. But you have to keep the practical decisions within the management of the institution.

Senator SARBANES. I think that is a responsive answer. Let me ask you this question: How many, if we just think about this, going down this path, how many Sears, Roebuck-type aggregations would you anticipate—first of all, would you anticipate each of them to have their own S. & L. division?

Dr. RIEDY. I think each of them will have their own mortgage lending type operation. A lot of them have mortgage banking firms right now.

Senator SARBANES. How many such aggregations would you expect this to have in the country, with these S. & L. divisions?

Dr. RIEDY. I do not know how many Merrill Lynches there are on the horizon, but we will find, as I mentioned earlier—with respect to the bank holding companies' buying up much of the mortgage banking industry—that evolution sort of died out and now they are rethinking it. We will have this surge, I believe, of financial conglomerates, and then there may be a backing off as they decide that it maybe was not as profitable as they thought it would be, as an investment.

Senator SARBANES. If I and some others are sort of the board of directors of an S. & L., what are the prospects for me of competing with the S. & L. division of Sears, Roebuck, or the S. & L. division of Merrill Lynch, or the S. & L. division of Citicorp, and so forth? What would be my chances of sort of working against them?

Dr. RIEDY. I think they will be good. But I also assume that we will have interstate branching and that the S. & L. that is not the conglomerate-oriented S. & L. will operate in many States, and will have to have, necessarily, good economies of scale by being big, in and of itself. It will have to play by the same rules, though—the same regulations.

Senator SARBANES. If we have that—that's an interesting point. If we have that, this interstate branching, wouldn't it be easier for Merrill Lynch or Sears, Roebuck to move down as it were into that area of activity than it would be for me? I am now positing, when I say "me," that I am a small single S. & L. who has been doing a good job for a long time in an area.

But how would I move from that position into this interstate range of activities that would enable me to compete with the S. & L. division of Sears, Roebuck or of Merrill Lynch?

Dr. RIEDY. I think what will happen, as I said, is that the economies of scale will become increasingly important. The smaller institutions will be bought up by larger institutions.

Whether we like it or not, that has already happened in the consumer credit field, and it is happening in the real estate industry. That is where we are going. We can resist it, but I think that is the inevitable conclusion of the need for economies of scale, whether or not we are in an inflationary environment.

Senator SARBANES. I see that your colleagues would like to comment.

Mr. COLES. We do not have to speculate on what an S. & L. division of Sears, Roebuck would be, or how it would compete. Sears, Roebuck for 20 years has owned a savings and loan in the State of California, Allstate Savings and Loan, and that association

has not, in my opinion, benefited greatly from its ownership by Sears. Its market share growth has not been extraordinary. Its return on net worth has not been extraordinary. And other independently owned S. & L.'s have more than held their own, so bigness itself I do not think provides a strong competitive edge.

I would much rather be competing against a branch of Bank of America who came to Houston than a branch of Texas Commerce Bank that is located in my own town. I do not fear the undue concentration.

Mr. WOOD. I was going to say that we have an example to look at by way of holding companies within the States, at least within mine. The holding company board does make the loan policy, does say where the money is going, even hires and fires the people at the local bank level without their local board's permission. I think you have adequately expressed our position, that is, we are concerned about big concentrations of credit. We do not believe that just because they are in these other fields that they should be treated as problem children, and that should not be regulated. We cannot permit large corporations to take over all the banking areas, real estate areas, and others, and we do not think that what is proposed here is going to solve the small savings and loan or thrift industry's problems in competing with those big boards.

I can visualize us sitting here next year, just like we were doing now, and saying the DIDC is not working, this is not working, this is not what Congress intended.

We think this legislation is a piecemeal approach—and agree that maybe we should move very slowly in this area away from our traditional concept. We should really look at the overall picture to try and react to it, as distinguished from coming in and saying, "You all can have the right now to compete with the commercial banks, and next week you can have the right to compete with real estate people"—which is the way Chairman Pratt is moving with this. He has already said you can get into property management. What is the next step? Where does it end? And they are in chartered, favored positions, whether we like it or not, and they are regulated.

Now, we have people who are competing that are not regulated. Let's look at that, and look at that overall picture, rather than piecemeal, saying, "Here, we will let you do this. Next week we will let you do this." We are moving in deregulation and we are getting complaints that the DIDC is not doing it right.

Senator SARBANES. I want to ask one other broad question of you, and that is the role of the Federal Government and the role of the State governments in the areas in which you all operate.

Mr. MASTERTON. Let me touch on a portion of that—

Senator SARBANES. And particularly with a sensitivity to the old aphorism that "what is sauce for the goose is sauce for the gander."

Mr. MASTERTON. I am not sure I can address that in the manner you would prefer, since I am not much of a cook, nor an economist.

But let me point out an area that perhaps may not be self-evident, but concerns both of your comments, and those of Chairman Garn. You have been concerned about the concentration of power, Senator. You have been concerned about the interstate

issues. We understand that we are going to be disadvantaged as an industry at this point in time with high interest rates. We are willing to take our bite out of the inflation apple along with everybody else. The problem is that the current thrust of regulation—I do not want to keep whipping on the DIDC, but obviously I am doing so—but the net result of those actions is to promote further concentration.

The answer is when our institutions get in difficulty to merge them out of existence, to concentrate them, by a policy of the Federal agencies. When two of our institutions cannot be merged with each other, and the regulator's priority may not be to merge two thrifts, there is more concentration—interstate, multistate, and so on. The direct result of DIDC's policies leads to interstate banking.

Now, what I am suggesting here is that Congress should be concerned about this de facto policy. We cannot say just that it is the problem of inflation, the problem of high money; it is the times. Those problems are being exacerbated by the actions of DIDC. It is happening and DIDC is accelerating the process—it is not just the issue of September 22 decisions but what they have done in the past. Issue after issue. We have had to go to the courts. We have prevailed in the courts.

Now, on that one portion of the issue, many of those issues are States' rights issues—the merger consolidations are States' rights issues. But it seems to us that the Congress has got to restate its position on this. What do you intend for interstate banking. What do you intend for concentration of resources? What do you intend relative to the support of institutions that are in extreme positions because of national policy relative to monetary control?

To just view DIDC as a separate instrumentality that is going to monitor the process of decontrol, in our opinion, gets back to earlier questions about what our reaction was to the earlier—last year's law, and the implementation of it. It is so far-reaching, it touches each of the issues that you are concerned about, Senator.

I hope today we have shed some light on that. It is not separate from the powers issue. We cannot sit and say, "Sure, I would like to favor John's position on realtors. I cannot get into his business." But I drove the other day from Hartford to New Haven, and I saw more Merrill Lynch realtors signs in front of houses for sale than any other firm. The realtors have latched up with the big firms. Senator Garn's concerns about the multiindustry groups are there.

When it comes down to the broadening of the powers for the thrifts, it just seems to me we cannot say these are new issues. These are issues we have been debating here for 20 years. We have got to look at structure in those institutions to be viable, or merge them out of existence, or put them interstate, or concentrate powers—because that is the alternative we are being presented with.

INTERSTATE MERGERS

Mr. BROOKS. In responding to your question, I think the current leadership of the regulatory agencies, if they had their way, would favor complete elimination, as far as State boundaries are concerned. There would be interstate mergers. The principal item in

the commercial bankers' testimony yesterday, I understand, was that one of their priorities was a takeover of thrifts by banks. And as far as the Federal Government is concerned, thank God we have the Congress, because the only appeal we have from the regulatory attitudes is in the Congress. The regulators are unlike the court system. There is no appellate court.

And we are appealing to you, because that is the only way, I feel, that we can save this thing from getting further out of hand. Lord knows what is going to happen to the thrift industry if it is not stopped. And it is not just the thrift industry; it's the homebuilders, the realtors, the commercial banks, the whole thing.

Dr. RIEDY. A quick comment. I think it is fair to say that regulation and legislation tend to follow market changes, rather than lead them. They respond to the changes. I think that is true at the State and Federal level.

In the mortgage market, the mortgage market has become a national market. One out of every two loans, basically, is sold interstate, at least from institution to institution. I think because the market has moved ahead to a national market, it is appropriate that the Federal Government has to take a lead to respond to the market forces, if the State governments have not.

The Congress did that with the usury preemption, and I think today here to a great extent we are agreeing that it is necessary for a due-on-sale preemption, and it is necessary also, as far as we are concerned, because of the evolution of the mortgage instrument, that those State laws that restrict the use of adjustable rate mortgages for certain kinds of lenders should also be preempted to follow the national market.

Senator SARBANES. You would not, then—if the Congress wished to make a substantive judgment in your area, with which you disagreed on the substance—would not come to the Congress and say to us, "You are not to address this issue. This is a State issue, which should be left to the States"?

Dr. RIEDY. I cannot answer the hypothetical question.

Mr. WOOD. Senator, with due respect, there are two of us here who are not quite in agreement on the due-on-sale issue. We do see that as a States issue which is working, basically, across the country, except within 14 States. And there is a lot of other things happening there, also. We do see that particular issue as one. But I wanted to make it clear, that we were not particularly in agreement on that one issue.

Mr. SHIMBERG. Leaving the due-on-sale issue aside, but with reference to other things, the Home Builders' position—and we recognize, and have more so over the years, that the operation of the secondary market is vital to mortgage finance in this country, and with all of the new instruments and all of the new mortgages that have come along in the last year or so, the adjustable rate mortgages, and all of the variations of that, we have to have standardization. Otherwise, the money is not going to be available, and it is not going to flow.

I do not know any other way that you can get that other than by the Federal preemption of the right of the States, in this particular area. I do not like it perhaps any more than you do. But the alternative seems to be an impediment to the free flow of mortgage

money, the packaging of mortgage-backed securities, and the operation of the secondary market—and without that market operating freely, and correctly, then we are in even worse trouble than we are now.

Senator SARBANES. I am getting at the inconsistencies that some assert to seek Federal action when they think it will serve their substantive purpose, but when they perceive it will not serve their substantive purpose, and in the process, take a process position that this is an area in which the States should act. At that point, they are simply trying to have it both ways, and we simply want to underscore that contradiction or inconsistency.

The CHAIRMAN. I would like to close by underscoring Senator Sarbane's underscoring. I agree with him completely on that point. I think we get a little tired of those who are States' righters when it is something they don't like, and when it isn't it is fine, they have a rationale. I don't think you can have it both ways.

Either you are for States' rights, or you are not. You cannot switch back and forth depending on the particular substantive issue, of how it affects you. That is why I get in conflict, and try to continue to insist whenever we have a Federal preemption that we put in the caveat that States have the right to offer need.

Senator Sarbanes is absolutely correct, you cannot have it both ways. And yet we see it argued in all of our committees both ways, over and over again.

Let me thank you for your testimony today, and for your articulate responses to the questions of the committee. I would just hope that we do not get back to piecemeal solutions. However we finally resolve this legislation, in what form, we hope we do not go back to a piece here and a piece there, because I think that is where we have created most of the distinctions over the years.

Thank you very much. The committee is adjourned.

[Whereupon, at 12:01 p.m., the hearing was adjourned.]

FINANCIAL INSTITUTIONS RESTRUCTURING AND SERVICES ACT OF 1981

THURSDAY, OCTOBER 22, 1981

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 9:30 a.m., in room 5302 of the Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn and Dixon.

The CHAIRMAN. The committee will come to order.

On the fourth day of our hearings on S. 1686, S. 1703, S. 1720, and S. 1721, we are happy to have three distinguished panels.

The first one is composed of:

David Silver, president, Investment Company Institute; Samuel C. Cantor, American Council of Life Insurance; Alfred Van Liew II, senior vice president, Rhode Island Hospital Trust National Bank; and Robert Garver, president and chief executive officer, Charlestown Savings Bank, Boston, Mass.

Mr. Silver, before you begin let me insert in the record a statement of Senator Lugar, as though read, since he is unable to be present today.

[Statement follows:]

STATEMENT BY SENATOR LUGAR

Senator LUGAR. Mr. Chairman, I am pleased to participate in these hearings on the tremendously important legislation you have introduced to begin the process of sorting out and rationalizing our financial structure.

I am also very grateful that you have included consideration of two issues of considerable significance to State and local governments. First, I sense that your bill, Mr. Chairman, to permit banks to underwrite and deal in municipal revenue bonds, has finally come of age. I supported this bill when I was mayor of Indianapolis and have been pleased to cosponsor it since being in the Senate.

I thought Treasury Secretary Regan's support of the idea on Monday was a constructive contribution to the debate. In the long term, the concept of the bank holding company subsidiary is very important when we reach the point of determining whether bank security activities should be expanded to cover private debt obligations. But the evidence does not suggest the need for such an affiliate in terms of underwriting State and local revenue bonds. Such bonds are no riskier than other public securities and in fact are omitted from the banks repertoire only by virtue of their nonexistence in 1933 when the National Banking Act became law.

In addition, banks are already equally regulated vis-a-vis the securities firms in their municipal securities activities by virtue of the 1975 Securities Act Amendments. Secretary Regan's argument regarding equal regulation already applies, therefore, since banks in this matter, are currently subject to the SEC's jurisdiction as are securities dealers.

Finally, I am not persuaded that banks enjoy any significant tax advantage over nonbank firms in their ability to do business in municipal securities sector. In fact, former Deputy Treasury Secretary Carswell 2 years ago testified that the impact of this "advantage" was de minimus under today's market conditions and suggested that the way to resolve the question was to give the nonbank securities dealers the same tax treatment enjoyed by the banks. I support that solution and suggest that we move ahead with the bill even if that issue is not resolved.

While I choose not to engage in a numbers game on the value of this legislation to States and localities, I am firmly convinced that no useful evidence exists to bar us from unbinding underwriting participation in the revenue bond market. Like every other sector of our free market, the banks collectively and individually have unique contributions to bring to the marketing of revenue bonds which can only work to the benefit of States and local governments whose market is indeed in difficult straits.

The other legislation of benefit to States and localities is my bill, S. 1686 which would permit State and local governments to establish NOW accounts. It would also permit waiver of interest rate ceilings on state and local demand deposits as well as to remove reserve requirements against such deposits. By so doing, banks would be free to pay interest on such deposits just short of the so-called Fed funds rate.

These measures offer cash management tools designed to afford public bodies a greater number of options on their cash. Clarification of authority to establish NOW accounts will benefit all State and local governments in that they will no longer be required to maintain transaction accounts which bear no earnings while cash is awaiting disbursement. On the demand account provision, smaller localities, which lack cash management sophistication and large sums of short-term cash for investment will be able to better utilize this cash without the need to engage in complex investment programs.

The Municipal Finance Officers Association has gathered data from the Federal Reserve which indicate that States and localities kept \$11.3 billion on demand last year. Had this money been earning at even a 5.5-percent interest rate, it would have produced almost \$600 million or 16 percent of the amount distributed through general revenue sharing. If much of this cash had been invested at even higher rates, the return could have been double that figure.

The Federal Government is necessarily cutting back on its financial assistance to State and local governments at a time when they are expected to provide more services to their citizens in a harsh economic environment. Both the revenue bond provision and S. 1686 are a way that we in Congress can say we are sensitive to your needs and problems and, in the spirit of deregulation, will

unfetter your ability to realize savings on the one hand and earn more on your scarce resources on the other. And, Mr. Chairman, I might note that this is an action that costs the Federal Government nothing. I appreciate the support of the mayors, finance officers, and others for both bills and look forward to working with the committee to enact these measures.

The CHAIRMAN. Mr. Silver, will you begin?

STATEMENTS OF DAVID SILVER, PRESIDENT, INVESTMENT COMPANY INSTITUTE; SAMUEL C. CANTOR, AMERICAN COUNCIL OF LIFE INSURANCE, ACCOMPANIED BY GARY HUGHES, CHIEF COUNSEL; ALFRED VAN LIEW II, SENIOR VICE PRESIDENT, RHODE ISLAND HOSPITAL TRUST NATIONAL BANK; AND ROBERT GARVER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CHARLESTOWN SAVINGS BANK, BOSTON

Mr. SILVER. I will summarize our prepared statement, if I may. [Laughter.]

The CHAIRMAN. If you had not, you would be here alone for a long time. [Laughter.]

Mr. SILVER. It is big enough so that we can beat the committee to death, if necessary.

I am David Silver, president of the Investment Company Institute, the national association of the mutual fund industry.

The institute appreciates the opportunity to testify before you on S. 1720, a significant legislative proposal that would substantially alter the structure of the Nation's financial institutions.

The provisions of S. 1720 would remove century-long restraints on bank securities activities. But let me state at the outset that the mutual fund industry is not wedded to the past, nor do we seek the shelter of exclusive franchises or special tax breaks. As an industry which is a leading innovator in the development of new investment products which serve over 12 million Americans, we recognize that legislative adjustments may be required to rationalize business and technological developments.

At this point, we cannot endorse the provisions of S. 1720 relating to the Glass-Steagall Act or the alternative proposal of Secretary Regan.

REGULATORY AND COMPETITIVE PROBLEMS

However, we can identify the two groups of problems—regulatory and competitive—which should be dealt with as an essential ingredient in any modification of the Glass-Steagall Act. Moreover, we can point in the direction where we believe solutions may be found.

In an effort to contribute to a constructive review of S. 1720, we have prepared a detailed position paper and formal written testimony. We have also submitted a paper by Prof. Lance Girton of the University of Utah, who is here today and would be pleased to respond to any questions.

The CHAIRMAN. Just by accident, somebody from my alma mater. [Laughter.]

Mr. SILVER. Professor Girton prepared this paper on the basis of work he had done some years ago.

The CHAIRMAN. I could not resist.

Mr. SILVER. I was waiting for it. [Laughter.]

Before dealing with the bill's specifics, three preliminary comments may be in order:

First, to the extent that the problems of savings and loan institutions require immediate attention, S. 1720 most assuredly deserves prompt consideration. But, to the extent that S. 1720 would permit bank re-entry into the securities business, prudence should be the watchword. Large banks are not in need of legislative help.

Second, it should be made clear that the portions of the bill dealing with mutual funds are not limited to money market funds; under these provisions, banks would be able to create and distribute mutual funds investing in corporate stocks and bonds—and this is precisely what the big banks have in mind.

Third, the portions of the bill permitting banks to create and sell mutual funds may, ironically, impair the financial stability of the very institutions Congress now seeks to promote.

To summarize our position on the merits, we believe that any legislative realignment that expands bank securities activities must be accompanied by a realignment of the regulatory structure. Moreover, competitive equity demands that changes should not be authorized by piecemeal legislation which addresses only one part of the problem.

The practical effect of considering only one aspect of change would leave banks their exclusive government franchise to conduct the business of banking, and thus aggravate the conditions which already give them an inherent and unfair advantage over all other financial institutions.

As demonstrated in Professor Girton's paper, banks are in the unique position to engage in a host of banking and nonbanking relations with customers which are denied to bank competitors. In addition, this paper vividly shows the startling degree of concentration of the holdings of America's largest companies in a few large banks and, indeed, the surprising degree to which these banks are interrelated to each other, increasing their economic leverage.

In short, we believe that those portions of S. 1720 dealing with the Glass-Steagall Act require careful study and considerable revision before Congress considers adopting them.

Our written testimony and position paper spell out in detail how the securities activities in which banks have engaged since Glass-Steagall have repeatedly caused substantial disruptions in the normal banking operations of major banks, and have placed large sums of public savings at substantial jeopardy without adequate safeguards or adequate disclosure of investor risk. The natural tendency has been to sweep these episodes under the rug, to prevent an erosion of confidence in our banking system.

But when Congress considers removing fundamental safeguards and revising historic national policies, it is time to talk frankly and openly about the problems that these safeguards are designed to prevent to see how they may be safely relaxed. Therefore, we believe that a study of these recent and current abuses is necessary, not for the purpose of casting our banking system into disrepute, but to provide needed insight into the appropriate regulatory

pattern which should be adopted if the Glass-Steagall Act is modified.

Three examples from our written testimony will suffice:

First, any impartial inquiry into whether the passage of time has rendered obsolete restrictions on bank securities activities must consider the problems of bank-sponsored real estate investment trusts during the 1970's. These REIT problems caused a substantial drain on major banking institutions. They involved large liabilities to bank REIT sponsors which often stemmed from classic conflicts of interests that the Glass-Steagall Act was designed to prevent.

What is not generally understood is that there was a grave regulatory lapse associated with the creation and subsequent operation of bank REIT's. The banking agencies failed to impose the kind of prohibitions which exist in the Federal securities laws, and most particularly in the Investment Company Act of 1940, against self-dealing and similar conflicts of interest which have historically plagued bank securities activities.

Second, during the same decade, the activities of bank underwriters of New York City obligations involved a major segment of the country's banking system in massive potential liabilities flowing from questionable securities distribution practices.

The failure here was clearly related to the fact that bank securities distribution activities are exempt from the Securities Exchange Act of 1934.

Third, and coming to the present, banks and other depository institutions are selling billions of dollars of so-called retail repurchase agreements, which are uninsured debt obligations of the issuing banks.

If the normal SEC ground rules contained in the Securities Act of 1933 applied, a number of depository institutions issuing these obligations would be compelled to disclose their true financial condition to investors who remain unaware to this moment of the very substantial risks involved in purchasing debt obligations of institutions experiencing severe financial difficulties.

But because of the bank exemptions in the Federal securities laws, investors today are being deprived of full and fair disclosure.

The lesson to be drawn from these and other recent events is that any legislation which would expand bank securities activities must vest the SEC with full securities law jurisdiction over all bank-sponsored pooled investment funds, all bank investment advisory services, and all bank retail distribution of securities.

Making the same point another way, the bank exemptions contained in the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 were all predicated upon Congress understanding that banks were barred from virtually every facet of the securities business by the Glass-Steagall Act. If the Glass-Steagall Act is obsolete, it follows that these exemptions are obsolete.

Our second major concern is that of competitive equity. Large banks that spearhead the drive to repeal the Glass-Steagall Act have stressed recent developments in the securities industry, arguing that fairness requires Congress to turn the clock back to the 1920's and permit banks to engage in expanded securities services.

But it is far from clear that developments in the securities industry to which the banks point present the competitive issues they claim.

In any event, as demonstrated by the statistical analyses in Professor Gorton's paper, the tie-in relationships which banks enjoy with their customers present a public policy problem of considerably more import than the entry of Sears or American Express into the securities business.

What is clear is that if Congress permits large banks to expand their securities activities, it will not only be the securities industry, but those small banks and savings and loan institutions which cannot afford to expand into the securities business that will be materially injured. But the ability of giant banks to offer expanded securities services and products also will have a serious impact on the continuing viability of an independent securities industry in light of the fact that securities firms will be unable to compete with banks in the banking business.

The proposal made by the large banks for expansion into the securities industry is a legislative one-way street. Under the provisions of S. 1720, banks would continue to enjoy a banking monopoly while entering the securities business, but securities firms will remain barred from the banking business.

Banks will then be able to exploit the multifaceted relationships with their banking customers to develop and enhance their new securities activities. To prevent enhancement of the existing competitive imbalance, it is imperative that any modification of the Glass-Steagall Act should be coupled with legislation enabling securities firms to obtain full banking powers.

But, even conferring banking powers on securities firms would only be one step in the alleviation of the competitive dislocations the large banks would achieve under S. 1720 as it now stands.

NATIONWIDE CORRESPONDENT SYSTEMS

An additional problem is posed by the McFadden Act and the Douglas amendment, which generally prohibit banks and bank holding companies from operating banks in more than one State. These restrictions on geographical expansion have led to the development of nationwide correspondent systems through which the largest banks provide numerous services to the small banks and their customers.

As has been made clear through the legislative proposals sponsored by large banks and by testimony here this week, if the Glass-Steagall Act is modified, large banks will utilize their correspondent relationships to distribute securities products and services through their well-established chains of local banks.

Securities firms stand outside of this correspondent system, which has grown and flourished in the protectionist shelter of the McFadden Act. This competitive disadvantage can only be ameliorated by permitting securities firms to engage in multi-State banking activities. There is no other way that the Congress can avoid competitive inequities created by addressing one statute at a time.

Dismantling the Glass-Steagall Act can bring about the destruction of an independent securities industry, not because that industry is inherently unable to compete effectively, but because large

banks will continue to enjoy the privileged sanctuary of protectionist legislation. This legislation has sheltered the commercial banking function from competition, as big banks reach out to enter other financial businesses whose products they can then offer on a tie-in basis.

For these reasons, the institute believes that there should be no legislative changes in the Glass-Steagall Act unless and until the Congress first addresses and resolves issues of adequate protection of the investing public and competitive equity.

The basic changes needed in the regulatory system which governs the Nation's financial structure cannot safely be accomplished on the basis of a few weeks of hearings. Rather, changes that will serve this country well in the long run must be carefully thought out, and can only be accomplished through the diligent efforts of all concerned.

This work should begin immediately. It will be a difficult task, but we pledge you the full cooperation of the mutual fund industry in seeing it through to a successful conclusion.

[Complete presentation of the Investment Company Institute follows:]

WRITTEN STATEMENT OF THE INVESTMENT COMPANY INSTITUTE
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN
AFFAIRS ON S. 1720, 97th CONGRESS, FIRST SESSION

(October 22, 1981)

My name is David Silver. I am President of the Investment Company Institute.

The Investment Company Institute is the national association of the American mutual fund industry; its membership includes over 600 open-end investment companies, or mutual funds, which account for over 90% of the industry's assets. Today, more than 12 million investors hold shares of mutual funds. Accordingly, we are vitally interested in preserving and enhancing both an efficient investment climate and a healthy banking system, and we greatly appreciate the opportunity to testify before you in connection with S. 1720.

Earlier this week the Administration advanced a different approach to some of the subjects addressed in S. 1720, which we welcome as a constructive addition to the dialogue on these issues. In addition to our written statement, we are submitting today a more detailed analysis of the issues facing this Committee which we believe require a comprehensive review.

Introduction

The legislation pending before this Committee, which has as its primary purpose assistance to a financially troubled savings and loan industry, is also described as "a bill [designed] to enhance the competitiveness of depository insti-

tutions. . . ."^{*} It is doubtlessly correct that S. 1720 would enhance the competitive status of certain, large, depository institutions, but at a disproportionately high cost to investors, smaller depository institutions and the securities industry.

Shifts in national policy of this magnitude require the thoughtful evaluation of compelling factual predicates. But, the predicates for this legislation have, as yet, not been amassed, much less considered. Instead, when this bill was introduced, it was suggested only that "[r]evisions must be made in the financial system's structure to accommodate the changes [in the financial services industry] which have occurred."^{***}

But, the bill under consideration would effect these totally new revisions by substantially repealing parts of the Glass-Steagall Act; among other things, the bill would authorize banks and other depository institutions to organize, underwrite and deal in the shares of mutual funds.

Whether the Glass-Steagall Act should be modified or repealed in this, or any, respect, we submit, requires a comprehensive review of the policies embodied in that Act;

^{*} 127 Cong. Rec. S. 11254 (Oct. 7, 1981) (daily ed.).

^{**} Id.

S. 1720, however, neither comprehensively addresses this question nor permits such a review to take place.

The Institute believes, for the reasons which we will discuss, that all of the major concerns and conditions which caused the Congress to enact the Glass-Steagall Act continue to exist today. Nevertheless, we agree that the advent of significant business and technological developments may well require that new legislation be devised to rationalize and harmonize these changes.

At the same time, it must be recognized that it is necessary, in designing changes in this important national policy, to reinforce the protections to the public against abuses arising from unregulated bank securities activities and to prevent unfair competition and unhealthy concentration of economic power in the hands of a few large money center banks.

Accordingly, any realignment of services that expands bank securities activities must also be accompanied or preceded by a realignment of the regulatory structure which provides appropriate protections to both investors and depositors. Moreover, change should not be accomplished by piecemeal legislation which would continue to permit banks to maintain their exclusive franchise to conduct the business of banking and thus aggravate the conditions which already give them an unfair advantage over all other financial institutions.

Changes in the Banking Business

It is undeniable that extensive changes have occurred in the way financial institutions conduct their business. To be sure, some of that change has originated with securities firms, but depository institutions have been the source of even greater changes in the structure of the financial markets.

In an attempt to cope with the interest rate ceilings imposed by federal regulation, depository institutions have, for example, begun selling various securities to investors, including retail repurchase agreements and small denomination notes. Banks' investment advisory services have expanded from individual trust management services to mass-marketed services with one-half trillion dollars under management, operating for the most part in a regulatory no-man's land -- outside the Securities and Exchange Commission's regulatory scheme and peripheral to bank regulation.

Depository institutions now conduct extensive brokerage activities, regardless of the fact that they are not subject to SEC regulation as securities brokers and dealers. Large banks have found a number of ways to conduct business across state lines, for example, by franchising their services through correspondent networks of banks and by permitting smaller banks to participate in their collective funds. And, finally, banks today are offering participations in collective investment media of various types: they sponsor closed-end funds; they

advise mutual funds; they sponsor common trust funds; and they aggressively mass-market interests in collective investment funds, to retirement plans and to individual employees in these plans, all outside the ambit of Securities and Exchange Commission regulation and, we believe, often contrary to Congress' intent.

While these circumstances dictate the need for a fresh look at our financial institutions, and a fresh consideration of the activities in which they should and should not be permitted to engage, the current efforts to expand financial services certainly do not suggest that the banks have been relegated to an unfavorable position. Bank profitability, according to a Federal Reserve Board staff study, is at record levels.*

Perhaps even more importantly, it is by no means self-evident why these changes in the structure of the financial services industry require any change in the Glass-Steagall Act. And, even if it is assumed that some change in that Act is appropriate, it is also unclear why change should afford certain large banks a one-way competitive advantage, not only enabling those banks to compete for securities business but

* "Profitability of Insured Commercial Banks," Federal Reserve Bulletin, Sept. 1981 at 657.

also insulating the same banks from meaningful competition in the banking business from the securities industry.

Certain of the changes that would be effected by S. 1720, either in its present form, or as the Administration now proposes to modify it, would produce extensive changes throughout our entire financial system. We are deeply concerned that these proposals have not been evaluated as carefully and as thoroughly as they need to be, before the Congress can proceed with confidence in this area.

The system of regulation that now governs the banking and securities industries is a complex, interdependent system. That system consists of numerous elements of both federal and state regulation, since it has never been the goal of federal law to preempt either state banking law or state securities law. Changes in any one part of this interlocking system must inevitably have effects throughout our whole financial system. Significant changes, such as those that would be produced by this bill, must be carefully evaluated from numerous perspectives.

It is our desire to cooperate with this Committee in laying the necessary groundwork so that, if a new legislative program is ultimately deemed appropriate, the legislation that ensues will produce beneficial changes, the effects of which are not outweighed by their countervailing impact on other important

aspects of the entire system. At a time when large banks are seeking to justify further expansion into the securities business, however, it is necessary to recall that, for over 100 years, it has been the judgment of the Congress that the federal banking laws should prohibit commercial banks and their affiliates from engaging in securities activities.

This long-standing judgment was not based on a desire to deprive banks of the opportunity to pursue profitable activities. It was based, rather, on Congress' concern that bank involvement in more speculative endeavors, such as the securities business, poses a significant potential for financial disaster. And, it is a lesson of history that banking financial disasters result in severe problems for the entire economy. Congress' concern is justified not only by historical events but, as we shall discuss, by the results of numerous recent and, indeed, current-day bank forays into securities activities.

It is difficult, in light of this recent history, to see how the continued growth and stability of the banking system will be promoted by opening the door to diverse securities activities, and thus a greater potential for disaster. It is particularly difficult to see how such activities, even if otherwise appropriate for banks, could be left largely free of the restraints of the federal regulatory scheme specifically designed for securities-related activities, a system of regulation that can, in the long run, only have a beneficial impact on investors.

In any event, this step should not be taken without adequate study and deliberation. Congress does not, at the present time, have before it a fully developed record of the many issues that are raised by the provisions of the bill under consideration, either as originally introduced or as the Administration proposes to amend it.

Federal Banking Regulation

It may be useful, at this point, to summarize briefly the history of the federal banking laws and the reasons that Congress has, from the origins of the national banking system, deemed it prudent to prevent commercial banks and their affiliates from engaging in the securities business.

It is important to recall that the policy of the Glass-Steagall Act, which the large banks now seek to change -- separating commercial banking from securities activities -- did not originate in the 1930's, as the large banks suggest. The statute is not a relic of the Depression era, with no continuing relevance to modern economic conditions.

Rather, from its origins in the nineteenth century, the national banking system has generally been predicated upon the separation of commercial banking from the securities industry, in view of the inherently risky and speculative nature of dealings in stock and bonds. Of course, this has not prevented

large banks, often aided by questionable interpretations of the law by the banking regulators, from such speculation.

The National Banking Act of 1864, which granted national banks limited and specified powers, was consistently interpreted to prohibit completely national banks from underwriting or dealing in non-Government securities.* Such was the case until the early 1900's, when the Comptroller of the Currency reinterpreted the Act to permit national banks to underwrite and deal in debt securities. Nevertheless, even the Comptroller concluded, in 1902, that the National Banking Act did not permit national banks to participate in the underwriting and distribution of equity securities.**

An opinion issued by the Solicitor General on November 6, 1911, and concurred in by the Attorney General, has particular relevance for the issues being debated today, seventy years later. Pointing out that national banks had always been limited to those powers expressly granted to them, the opinion held that national banks were precluded from organizing, underwriting or investing in the stock of other companies. The reason stated in the opinion is that:

* Department of the Treasury Issues Paper, Public Policy Aspects of Bank Securities Activities, Appendix, at 2 (1975).

** Redlich, The Molding of American Banking—Men and Ideas, Vol. 2 at 389, 393 (1951).

"...there is a larger interest, that of depositors and the National Government, which requires that the bank shall be conducted as a bank pure and simple and not as a promotion agency of speculative investment companies."*

In order to avoid these legal prohibitions on their securities activities, large money center banks resorted to the now-familiar device of creating non-bank affiliates. There followed the familiar pattern of the bank regulatory authorities not only failing to enforce the existing restrictions, but lobbying on behalf of the commercial banking industry to break down completely the historic separation of commercial banking and the securities business.

These efforts on behalf of the banking industry eventually resulted in the passage of the McFadden Act in 1927, which permitted national banks to underwrite securities to the extent authorized by the Comptroller. The Comptroller soon granted national banks extensive authority to underwrite both debt and equity securities.** Thereafter, "commercial banks became increasingly more active in the securities markets; their

* Opinion of Solicitor General Lehmann, November 6, 1911, quoted in 75 Cong. Rec. 9899, 9902 (1932).

** Perkins, The Divorce of Commercial and Investment Banking: A History, 88 Banking L.J. 483, 494 (1971).

market share of new bond issue participations increased from 37% in 1927 to 61% in 1930. . . . By the end of the decade commercial banks and their affiliates had become the dominant force in the investment banking field."*

Thus, by 1930, large commercial banks, through their securities affiliates, had virtually destroyed the traditional barriers between commercial banking and the securities business. Myriad abuses occurred as a result of the commercial bank entry into the securities business in the 1920's. As documented by the Congress, these abuses included

- causing bank securities affiliates to make investments considered too "risky" for the bank itself;
- dumping bad bank loans and investments into securities affiliates' portfolios;
- the purchase by banks and controlled trust accounts of unsuccessful issues underwritten by bank securities affiliates;
- imprudent and excessive bank loans to prevent the collapse of securities affiliates;
- favorable consideration of requests for bank loans by purchasers of securities underwritten by affiliates, and by corporations using securities affiliates as underwriters;
- abuses of relationships with correspondent banks to help distribute securities affiliates' underwritings; and

* Id., at 495.

-- personal self-dealing by bank officers and directors in the operation of securities affiliates.*

By the early 1930's, therefore, there had developed a national consensus that the brief departure from the sound historical policy of separating commercial banks from the securities business had been a major contributor to the Great Crash and the ensuing depression. As a result, Congress enacted the Banking Act of 1933 (the Glass-Steagall Act), which restored this historic separation by providing that a national bank "shall not underwrite any issue of securities or stock" and shall not purchase "for its own account . . . any shares of stock of any corporation." Similarly, a national bank was prohibited from engaging in "the business of issuing, underwriting, selling or distributing, at wholesale or retail, or through syndicate participation, bonds, debentures, notes, or other securities."** In light of this broad prohibition on securities-related activities, Congress included in both the Securities Act and the Securities Exchange Act numerous exemptions for banks from the provisions of the federal securities laws.

* Hearings before a Subcommittee of the Senate Committee on Banking and Currency, 71st Cong., 3d Sess. Part 7, at 1063-64 (1931).

** Banking Act of 1933, Pub. L. 73-66, Ch. 89, 48 Stat. 162 (1933).

In the nearly half a century since the enactment of the Glass-Steagall Act, Congress and the courts have often been asked, but have steadfastly refused, to return to the dangerous pattern of the late 1920's. Nevertheless, banks have found various avenues to more speculative businesses. As we will now discuss, however, recent events only serve to reemphasize the need to maintain and reinforce the separation between depository institutions and the general securities business.

These events include:

- the massive sale of uninsured debt obligations, often by institutions in shaky financial condition, who misrepresent both the nature and safety of such investments;
- the widespread dumping of the debt securities of New York City by the banks who were the underwriters of those securities, despite their conflicting fiduciary obligations to public investors;
- the re-creation of the same conflicts of interest that contributed to the New York City fiscal crisis in connection with the investment activities of bank trust departments;
- mass-merchandising by banks of interests in bank collective funds for retirement plans, totally free of securities law regulation;

- bank sponsorship of funds, such as the ICU Government Securities Program, a common trust fund for credit union investors, which was reported last week to be "technically insolvent" as a result of portfolio valuation techniques that would never be tolerated in an SEC-regulated mutual fund; and
- the banks' recent venture into real estate investment trusts on a massive scale, leading to financial disaster for investors in such speculative ventures and the banks as well.

Retail Repurchase Agreements and All-Savers Certificates

A current phenomenon which graphically demonstrates the extent to which depository institutions are willing to place themselves and investors at financial risk in order to compete for short-term capital is the extensive promotion of so-called retail repurchase agreements ("retail repos"). More than \$14 billion worth of these securities have recently been sold by depository institutions.*

* Fed. Res. Rel. H.6., Money Stock Measures and Liquid Assets, Oct. 9, 1981.

Retail repos are, in economic reality, uninsured debt obligations of the issuing financial institution. They are not deposits, and thus are not covered by federal insurance programs; in addition, they are not subject to SEC disclosure and operational requirements, as mutual funds are.

Consequently, the manner in which retail repos are marketed to the public raises serious concerns, and the spectre of serious injury to investors. The complex nature of retail repos has led to confusion in the minds of investors, since they are often marketed in a way that makes them appear to be simple, insured deposits, which they are not. Customers are often not adequately advised that they may become unsecured creditors of shaky depository institutions, to the full extent that the market value of their security interest should fall below the amount of the funds invested.

The marketing of retail repos is attended by other serious disclosure deficiencies. Among other things, retail repos have been promoted by means of advertisements which do not provide appropriate disclosure of the offering bank's financial condition, the nature and terms of the agreement (including minimum investment denominations, interest rates, maturities and any prepayment fees), and the nature of the security underlying the investment.

Retail repos have even been merchandised in ways that imply that the investor is either making a deposit with a bank

or obtaining an interest in a government security, not in a debt security issued by the bank.

Despite the fact that the Comptroller of the Currency and the Federal Home Loan Bank Board have each interdicted retail repo advertisements that use words and phrases such as "guaranteed," "no risks," and "withdrawable accounts," or which imply that the investment is federally insured or guaranteed,* retail repo advertisements often use these misleading descriptions. The samples of recent advertisements which we are submitting for the Committee's review today repeatedly use terms such as "Guarantee," "Guaranteed," "Guaranteed Return" or "Guaranteed Interest."

Similarly, although the banking authorities have ruled that it is misleading to imply that there is any relationship between a retail repo and a money market fund, virtually all the advertisements use the terms "Money Market Fund," "Money Fund" or "Fund." Moreover, several of the institutions have selected names for their retail repo offerings that bear a close resemblance to the names of actual money market mutual funds registered with the SEC under the Investment Company Act.**

* See Comptroller of the Currency, Banking Circular No. 157 at 3 (May 13, 1981); Federal Home Loan Bank Board, Memorandum No. R51A.

** A selection of recent repo advertisements is submitted herewith as Exhibit A.

This has naturally led to investor misapprehension, so much so that the Washington Post was misled into reporting that the Central National Bank of Silver Spring was operating a "money market fund."* Furthermore, institutions which offer retail repos have ignored the regulators' demands that the absence of federal insurance be clearly shown in bold type.

Thus, although there has been some monitoring by the federal banking agencies, the repeated use of prohibited practices in advertisements is startling evidence of their ineffectiveness. And the purported goal of the regulators --to enable the public to distinguish between the characteristics of an insured certificate of deposit and an uninsured retail repo -- has not been successful. Bank promotional literature blithely states that the agreements are secured by the "U.S. Government" or "U.S. Government agency securities." Finally, while the bank regulators require the issuing institution to describe its retail repo agreement as one to repurchase for a "fixed amount,"* the offering materials and advertisements have often promised a return expressed in terms of interest rates, based on either daily or weekly computations.

While banks may be selling retail repos to shore up their financial condition, the fact is that retail repo activity

* Washington Post, May 29, 1981, p. D.3. This article is attached hereto as Exhibit B.

has apparently exacerbated the financial problems of issuing banks. The banks' assumption of such liabilities has caused concern that the capital/risk asset ratio of banks is reaching dangerous levels. This has already necessitated closer monitoring by the banking agencies. Some banks that have started marketing retail repos have experienced an increase in their liabilities to an extent which calls into question the adequacy of their capital structure. As a consequence, regulatory responses, ranging from admonitory letters and special examinations to threatened court hearings, have been required.

Similar to the banks' experience with repos, we believe that the features of S. 1720 which would permit banks to enter other aspects of the securities business would not have a stabilizing effect on the banking industry, but would result in the further deterioration of the financial condition of many institutions.

Significantly, the full disclosure requirements of the federal securities laws do not apply to retail repos because they are, technically, securities issued by a bank. The failure of the banks and the savings and loan associations to abide by even those minimal requirements established by the bank regulators, however, as well as the inability or unwillingness of the regulators to enforce their own rules, demonstrates the extent of the banks' willingness to induce

investors to place their money into speculative instruments in the absence of adequate disclosure regarding the nature of the investments. Indeed, banks have affirmatively misrepresented the nature of such investments and the risks associated with the purchase of a retail repo.

The misinformation with which banks promote the instruments they offer, however, has not been limited to retail repos. Aided by costly tax concessions granted by the Congress, and a full-scale media campaign, depository institutions recently sold more than \$15 billion worth of all-savers certificates during just one week. As a recent Wall Street Journal article pointed out, however, "[w]hile the media blitz helped boost sales . . . many of the ads are filled with a jumble of tax information and misinformation."* For example, many of these certificates have been promoted on the basis of the higher 1981 tax rates, even though no certificate can mature until 1982. Many advertisements are also contradictory: while one bank has proclaimed that a couple earning \$20,000 is in the 32% marginal tax bracket and would have to earn 17.85% on a taxable investment to equal the all-savers yield, another institution claims the same couple would be in the 25% bracket and would have to earn 16.18%.**

As the banks' recent experience with retail repos and all-savers certificates shows, when banks acquire a salesman's interest in the promotion of securities, the problems addressed

* Wall Street Journal, October 12, 1981, at 52.

** Id.

by the Glass-Steagall Act are resurrected and brought into play. In particular, the banks' rush to retail repos shows the need to maintain the traditional prohibitions against these securities-related activities, or to subject fully those activities to the strict body of SEC regulation designed to protect the interests of investors.

The New York City Fiscal Crisis

One of the principal provisions in the bill under consideration would permit banks to expand their municipal bond underwriting activities. It may be particularly appropriate, therefore, for the Committee to consider the extent to which the public interest can suffer when the various financial interests represented by a bank come into conflict as a result of a bank's securities activities.

The conduct of the major New York banks in connection with the New York City (the "City") financial crisis of 1975, a financial disaster the effects of which are still being felt, provides such an example. While the underwriters of City debt securities included securities firms and banks,* the banks which were primarily involved were ultimately found by the SEC to have divested themselves of City securities (held in their own accounts and in their fiduciary accounts), at the expense

* Banks are permitted under the Glass-Steagall Act to underwrite and deal in general obligation government securities offerings.

of individual investors of modest means. These banks were some of the nation's largest, including Chase Manhattan Bank, First National City Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, and Bankers Trust Company.*

From October 1974 to April 1975, the City offered and sold through its underwriters about \$4 billion of short-term debt securities. In connection with the sale of these securities to the public, representations were made emphasizing the financial strength of the City and its capacity to meet both its principal and interest obligations on a timely basis.

Throughout this period, however, the underwriters had detailed knowledge of the City's financial crisis and its related problems: the growing gap between the City's revenues and expenditures; the use of short-term borrowing which had to be rolled over continuously to cover the gap; the widening of the gap during the 1974-1975 fiscal year; and the rapid growth of the City's short-term debt. The underwriters became increasingly aware during this period that the City would soon be unable to continue to finance its ever-increasing deficit, and that the representations being made to investors about the City's financial condition were false.

* Securities & Exchange Commission, Staff Report, Transactions in Securities of the City of New York, Chapter 4; Report on the Role of the Underwriters 31.

The underwriters realized that, because of these conditions and the fact that the market had become saturated with billions of dollars worth of City securities, their capacity to distribute additional such securities had been significantly impaired. The underwriters were also aware of serious doubts regarding the basic underpinnings of the City's Bond Anticipation Notes ("BANs"), Revenue Anticipation Notes ("RANs") and Tax Anticipation Notes ("TANs") -- the availability of revenues to cover the RANs and TANs and the marketability of bonds or the availability of revenues to redeem the BANs. Despite this knowledge, the underwriters continued to make representations concerning the safety of the City securities they were selling, and failed to disclose material facts concerning those securities.

As the fiscal crisis became particularly severe in early 1975, the underwriters continued to offer and sell City notes to the public as safe and secure investments without disclosure of significant risks. At the same time, certain of the banks had decided to reduce or eliminate their own holdings of city securities and the holdings of trust accounts which they controlled. As the crisis worsened, the principal officers of the underwriters became actively involved in discussions concerning the City's fiscal crisis, the continued marketability of City securities, and the inadequacy of the disclosures being made to the investing public. Nonetheless, in early 1975, under intense pressure from City officials, they proceeded, without

adequate disclosure, to offer over \$1.5 billion of City notes.

In the SEC's published report on this matter, the Commission pointed out how, to overcome a marketing problem caused by the saturation of the market through previous offerings and growing doubts as to the City's financial status, the City and its underwriters reached out for investors of modest means by selling City notes in smaller denominations. This action had the effect, at least in part, of shifting investment risk from the City's major banks and other large institutional investors. The SEC's report also detailed how the banks continued to underwrite City securities without disclosing material information concerning the City's financial crisis to the smaller investors they persuaded to invest.*

As the SEC, as well as the New York State Office of Legislative Oversight and Analysis found, the big New York City banks, as well as other major banks across the nation, eventually unloaded approximately \$2.3 billion in New York City securities between the summer of 1974 and March 1975, when the market finally collapsed. During this period, many of the same banks were underwriting and attempting to assist in the sale of billions of dollars worth of new debt issues which the City

* See Securities and Exchange Commission, Staff Report on Transactions in Securities of the City of New York, Chapter 4: "Report on the Role of the Underwriters," pp. 72-74 (1977).

required in order to stave off default, at the same time banks were getting rid of City securities held for their own accounts and in their fiduciary accounts.

The banks' dealings in New York City securities demonstrate the conflicts of interest which arise when banks are permitted to engage in securities-related activities. This web of conflicts is probably inherent in the multi-faceted relationships that a bank will inevitably have with its customers and its community. If new and different types of securities activities are to be permitted by the Congress, the potential for these kinds of conflicts will multiply. Such activities, if permitted, must be brought within the system of SEC regulation developed to protect investors, and be made subject to all the requirements of the securities laws.

Bank Trust Departments

Bank trust departments currently administer in excess of one-half trillion dollars in trust assets, either in individual trust funds and collective funds for retirement plans.* While there is no compelling reason why banks should be in the trust business at all, the combination of commercial banking functions and trust functions inescapably presents serious conflicts of interest. As Austin Scott, preeminent authority on trust law, wrote in 1936:

* Federal Financial Institutions Examination Council, Trust Assets of Banks and Trust Companies -- 1980, at 10.

It was perhaps something of an accident that the corporations which have obtained power to administer trusts are banking institutions. There is no necessary connection between the business of banking and the business of administering trusts. Indeed, many difficulties have arisen from the attempt to combine these two powers.*

The fact that the proposed legislation would subject new bank mutual funds to regulation under the Investment Company Act, moreover, cannot alleviate the basic conflicts of interest between a bank's role as a fiduciary to its trust customers and its more customary role as a commercial lender. To the extent that banks become more active in securities investment activities, they will inevitably be subject to more pressure from their commercial customers to make investment decisions that are influenced by their other profitable activities.

For example, when a controlling or influential block of a company's stock is held by a bank trust department, conflicts may exist by virtue of a bank's desire to keep control of the company in the hands of management that will remain friendly to the bank.** When a takeover bid threatens a bank commercial

* Scott, Fifty Years of Trusts, 50 Harv. L. Rev. 60, 62 (1936).

** The case involving Denver U.S. National Bank is illustrative of this problem. The bank chose to sell Denver Post stock held in trust accounts to a client with whom the bank had strong ties, rather than to S.I. Newhouse, even though Newhouse was willing to pay a significantly higher price. See House Subcommittee on Domestic Finance, Committee on Banking and Currency Staff Report, Commercial Banks and Their Trust Activities: Emerging Influence on the American Economy, 90th Cong., 2d Sess., Vol. I, at 780 (1968).

customer whose stock is also held by the bank trust department, for example, the bank's commercial arm may have an interest -- potentially in conflict with the interests of the bank's trust customers -- in thwarting the takeover.

Several examples of such situations are set forth in our detailed analysis. Perhaps the recent battle for control of Conoco, among DuPont, Seagram and Mobil, provides the clearest illustration of the conflicts of interest that can afflict bank funds in corporate takeovers. In the Conoco case, Bankers Trust of New York was listed as the single largest holder of stock in Conoco, holding in excess of 5.6 million shares. Moreover, Bankers Trust held more than 13.3 million shares of Mobil, making it also the largest holder of the securities of that company, whose acquisition overtures Conoco management was vigorously resisting. Finally, Bankers Trust was the twelfth largest holder of DuPont stock. Citicorp ranked as the second largest holder of Conoco stock, the fourth largest holder of DuPont, and the fifteenth largest holder of Mobil. Chase Manhattan was the fourth largest holder of Conoco stock, the fifth largest holder of Mobil, and the twenty-first largest holder of DuPont.*

The position of Bankers Trust should be of particular interest to the Committee because, in addition to substantial holdings in all three companies, Bankers Trust managed the employee stock plans of all three companies.** Thus, Bankers

* CDE Stock Ownership Directory: Energy (Corporate Data Exchange, Inc; 1980).

** Id.

Trust was able to vote on behalf of the employee/shareholders on all sides of the Conoco takeover transaction.

A bank's relationships with its trust customers and a corporate customer which becomes the target of a takeover bid is often further complicated by the loan arrangements made with respect to the proposed acquisitions. As Rep. Berkley Bedell pointed out in a recent letter to the Federal Trade Commission in which he urged the FTC to investigate the role of institutional investors in the recent wave of major corporate mergers, "in the case of some of the largest banks, the question is compounded by the fact that some of the same institutions are deeply involved in the financial arrangements attendant to the pending mergers."* These complications include the fact that banks often receive inside or market information in connection with making those financial arrangements, raising difficult issues with respect to the banks' obligations to investors in a bank trust account which holds shares of the affected companies.

One analyst has reported that in virtually every bank trust department study, it has been acknowledged that bank decisions to sell the securities of good commercial customers have "created a lot of flack."** Unfavorable customer reaction

* Letter from Rep. Berkley Bedell to Hon. David A. Clanton, Chairman, Federal Trade Commission (July 21, 1981), reported in Wall Street Journal (July 24, 1981), at 23, col. 5.

** Herman, Conflicts of Interest: Commercial Bank Trust Departments 51 (Twentieth Century Fund, New York, 1975), at 53.

has reportedly restrained the selling activity of bank trust departments on numerous occasions, often with adverse effects on trust department customers.*

Conflicts of interest also arise because customers vary in importance to the bank and in sophistication, sensitivity to performance and willingness to apply pressure. For example, if a bank buys securities to accommodate customers, the securities have to be placed somewhere and they may tend to gravitate toward the bank's less sensitive funds.

One bank trust department bought a large amount of bonds of a customer with which it had an interlocking directorate. The common stock of the customer was not on the trust department's approved list, but the bank was expected to purchase the bonds in return for the directorship it held, its appointment as collection agent on the bond issue, and a good customer relationship in general.

Most of these bonds were then placed in either a common trust fund or a nonprofit trust account managed by the bank. An examination of fourteen trust portfolios held by this bank revealed that "special notes of the bank's own customers tended to show up regularly in the common trust funds and in nine of ten randomly selected portfolios of small non-profit accounts but in only one of three portfolios of major companies."**

* Id. at 51.

** Id. at 63.

The danger that desirable stocks will be placed in the most performance-sensitive bank funds and that undesirable stocks will be placed in less sensitive funds or trusts will only increase if banks are given the power to create new mutual funds that they will naturally be anxious to promote to investors. In addition, banks may attempt to accommodate their corporate customers by placing securities offered in private placements in the funds they manage. In short, the many pressures that will be placed on banks can be expected to result in detriment to the portfolios of the bank's less sensitive customers, in order to improve the performance of a more sensitive fund or to accommodate an important customer.

Many persons have contended, over the years, that the inherent conflicts of interest created by the activities of bank trust department activities can be dealt with only by requiring the divestiture of such activities by banks. Others would attempt to alleviate the problems created by such conflicts by bringing them under the full requirements of the regulatory system of the federal securities laws.

But, one thing is certain: the Congress cannot safely ignore the substantial problems created by the fact that one-half trillion dollars worth of securities are now under the management of bank trust departments which operate largely without reference to the requirements of securities regulation. Before Congress authorizes banks to engage in even

more securities activities, the problems created by the present situation must be thoroughly considered and addressed.

Bank Collective Investment Funds for Retirement Plans

As serious are the problems created by bank trust departments, the conflicts are far more severe when a bank trust department not only renders advice, but also originates and merchandises interests in a pooled investment fund to thousands of investors.

We have fully documented, in the detailed Analysis which we are submitting to the Committee today, the serious abuses which characterize the marketing and operation of bank collective funds for retirement plans. These practices include false and exaggerated advertising claims; the failure to disclose investment policies and advisory fee practices and the ability to change such policies and practices without the necessity of a shareholder vote; delays in investing new money and in redeeming the interests of investors who demand payments; and the deposit of a substantial amount of cash in non-interest bearing accounts.

These abuses can flourish because these bank collective funds for retirement plans, which had assets at the end of 1978 in excess of \$47 billion,* are not subject to the provisions of the Securities Act of 1933 or the Investment Company Act of 1940. While the legislative provisions under consideration could require banks to register their new mutual funds under the

* Collective Investment Funds Survey Report, (American Bankers Association) at 7 (1979).

Securities Act and the Investment Company Act, no similar requirement is included within S. 1720 for the enormous sums of money the banks are already managing. It is worth noting at this point that the materials contained in the detailed analysis conclusively show that there is no justification for permitting collective bank funds for retirement plans to continue to operate outside of that regulatory framework.

The ICU Fund

National banks were first permitted to pool bona fide trust assets in common trust funds in 1937 in order to achieve diversification and administrative economies.* The Federal Reserve Board, and later, the Comptroller of the Currency have prohibited the merchandising and advertising of interests in bank common trust funds.** Congress exempted bank common trust funds from the federal securities laws and, instead, they are subject to the Comptroller's Regulation 9.*** As of 1978, bank common trust funds had assets of \$27.8 billion.

The absence of regulation under the federal securities laws has created serious problems for investors in these funds. A current example is the ICU Government Securities Program ("ICU Fund") which was established in 1968 as a common trust

* 2 Fed. Reg. 3440-41 (1937).

** 12 C.F.R. § 918(b)(5) (1978).

*** 12 C.F.R. Part 9 (1980).

fund by its sponsors, the First Wisconsin National Bank of Milwaukee ("First Wisconsin") and the ICU Services Corporation ("ICU"), an affiliate of a credit union trade association.* As of the beginning of 1977, the fund accounted for nearly 15 percent of all federal and state credit union assets available for investment, and its assets exceeded 20 percent of the combined assets of all regulated money-market funds.

A review of the reports filed by the ICU Fund as of 1978 revealed that many aspects of the Fund's operations would not have been permitted under the Investment Company Act.

For example, the Fund's reports showed that it paid Brown Brothers Harriman & Co. ("BBH") adviser's fees and Chase Manhattan Bank ("Chase") computer services fees by establishing compensating balances in non-interest bearing commercial checking accounts maintained at BBH and Chase. The use of compensating balances conceals the amount of the fee paid and inhibits accurate comparison of the Fund's advisory expenses with the expenses of other funds. This practice makes it virtually impossible for a credit union investor to determine the cost of managing his funds, and likely would not be permitted under the Investment Company Act.**

* The SEC exempted the ICU Fund from regulation under the Investment Company Act, except for certain limited reporting requirements, on the basis of representations made by the Fund sponsors as to how the Fund would operate.

** See Investment Company Act, Section 15(a)(1), 15 U.S.C. §80a-15(a)(1) (1976).

Of even more serious consequence, the Trust Agreement between ICU and First Wisconsin contained an arrangement whereby the Fund deferred both unrealized and realized market gains and losses from month to month. Under the Trust Agreement, no more than one-fifth of the net gain or loss in any one month may be added to or deducted from the ICU Fund's income. Although the SEC has permitted certain institutional money-market funds to value their assets on an amortized cost basis, rather than a "marking to market" basis, registered funds have never been permitted to use an accounting method that requires automatic deferral of up to 80 percent of their unrealized gains and losses.*

The ICU Fund's 80 percent automatic deferral policy distorted the ICU Fund's rate of return and net asset value per share and artificially insulated the Fund from the market fluctuations which registered funds are required to disclose. In this connection, it was reported in the October 12, 1981, edition of CUIS Newsletter, an independent newsletter for credit unions, the ICU fund is "technically insolvent," and it is not clear whether the fund would have enough money to pay off all investors, in the event of a "run." Account balances at the end of August totaled \$758 million, while the total market value of the fund's assets (cash plus investments) totaled only \$708 million.

* SEC, Investment Company Act Release No. 9786, 12 SEC Docket 715 (June 7, 1977).

The REIT Experience

The recent record of bank involvement in real estate investment trusts ("REITs") in the 1970's provides yet another instructive reminder that the temptations and abuses that the Glass-Steagall Act was intended to prevent are not simply phenomena of the Depression, but have continuing relevance today. Moreover, it is important to note, in connection with Secretary Regan's testimony, that in many cases, the REITs were not managed by banks, but by bank affiliates.

REITs are investment vehicles that are strikingly similar to mutual funds. While REITs invest in real estate, often a majority of a REIT's portfolio will be invested in mortgages and securities, rather than in hard real estate assets. The function of a REIT, like that of a mutual fund, is to make available to investors of relatively modest means a diversified investment portfolio under professional management.

REITs often have organizational structures that are similar to those of mutual funds. Typically, REITs are organized, managed, and promoted by an external management organization. They seldom have more than a few employees of their own, relying instead on the officers and employees of their external advisers to manage their business.

Like advisers to mutual funds, REIT advisers have an incentive to increase the assets under their management through

superior performance and the continuous sale of new securities, since an increase in assets results in increased profits for the adviser, who generally is paid a management fee based upon a percentage of assets. Thus, as assets under management grow, the adviser's fee increases.

Banking institutions became interested in REITs in the late 1960's, and a number of large banks and their affiliates organized and promoted REITs. Banks and their affiliates were in a unique position to profit through the management of REITs. Not only could banks and their affiliates receive advisory fees, they could also profit as a result of the bank's role as a real estate lender. Since the bank controlled the REIT, the bank could set the interest rate and other terms of the borrowing, thereby assuring itself of an especially lucrative loan business. As new assets were brought under management through highly leveraged borrowing by the REITs, the bank was able to charge higher management fees.

The numerous transactions between banks and their REITs created other temptations for abuse. For example, unlike non-bank advisers, bank sponsors of REITs were able to profit from the "float" generated by the loan transactions of their affiliated REITs.

Developers who obtained loans from a bank could also be encouraged to use the bank as a depository for the monies loaned by the REIT and to enter into other banking relationships with the bank managing the REIT. The banks were able to maintain

substantial cash balances in their REITs' checking accounts, to the detriment of the investors.

Banks also channeled loans from the REIT to developers on the basis of the profitability of the bank's own relationships with the developers, used their affiliated REITs to avoid regulatory restrictions on land and development loans to their customers, and sold loans from their own portfolios to their affiliated REITs when they needed to increase their liquidity or to free up money for other purposes.

Bank-sponsored REITs frequently claimed that they enjoyed an advantage in access to credit as a result of their affiliation with a bank. In fact, this "advantage" led to serious problems. Easy access to credit, coupled with the incentive for over-leveraging created by the advisory fee structure, led REITs to overcommit themselves with short-term borrowings that were highly sensitive to changes in interest rates. When interest rate changes swept the financial system in 1973, REITs discovered that the high cost of their short-term borrowings cut into earnings and dividends. Lower earnings and dividends, in turn, began to affect REIT stock prices, credit ratings and ultimately their ability to raise funds.

As the problems of the industry grew, REITs increasingly turned to their banks for loans. At the end of 1972, the REIT industry had \$14 billion of total assets, only \$3 billion of which represented loans from banks. One year later, REIT industry assets had increased to \$20 billion and bank credit to

\$6.5 billion. By the fall of 1975, total assets of the REIT industry amounted to approximately \$19.4 billion -- including nearly \$10.4 billion in bank credit.

By the end of 1975, REITs were even deeper in debt to their banks and the quality of their loans had deteriorated substantially. One study found that approximately \$1.75 billion of the REIT loans it surveyed had been compromised by the banks, that is, the loans had been restructured to bear a lower interest rate than the contractual rate, payments were being made on an interest-only basis, or the loans were otherwise not producing full income.*

Thus, banks came to be publicly linked with the fortunes and misfortunes of their REITs. This development was promoted by a number of factors, including widespread use of names that identified REITs with their bank sponsors and the overlap of bank and REIT personnel. Because of the public identification of REITs and their bank sponsors, banks felt considerable pressure to rescue their REITs. Banks were compelled to invest their own assets in REIT investments, provide their REIT affiliates with imprudent extensions of credit and subsidize REIT operations to an extent never envisioned.

* Real Estate Investment Trusts and the Effect They Have Had and May Be Expected to Have on the Banking System: Hearings on S. 2721 before the Senate Committee on Banking, Housing, and Urban Affairs, 94th Cong. 2d Sess. 22, 23-24 (1976).

Rescue efforts took a number of different forms. The primary technique was the loan swap. When a bank-sponsored REIT began to suffer cash flow shortages, the bank would purchase its troubled loans. Chase Manhattan Bank eventually acquired \$235 million in loans from its affiliated REIT, of which more than \$130 million was non-earning. Chase also assumed an additional \$34 million of unfunded loan commitments to borrowers. Another rescue mission involving swaps as well as straight cash payments took place in 1975 between First Wisconsin National Bank of Milwaukee and its troubled REIT. To settle claims brought by the independent directors of the REIT, alleging that the bank adviser had been negligent in placing certain loans, First Wisconsin agreed to purchase from its REIT participations in two mortgage loans valued at \$14.48 million. It also agreed to reimburse the REIT up to \$5.5 million for losses on other loans.*

Continental Illinois Bank also engaged in such a rescue mission, purchasing at least \$61.2 million of loans from Continental Illinois Realty.** Continental's efforts to rescue its REIT also included swaps, in which the REIT traded property to the bank and, in return, the bank cancelled debt that was earning only token interest. Continental had the pick

* Keefe, Bruyette, & Woods, Inc., Bank Loans to REITs: How Serious That Problem 81 (May 2, 1975) [Special Section of the 1975 Bank Stock Manual].

** Id.

of the best property, which it managed and later sold at a profit. Unfortunately, the REIT shareholders did not fare as well with their investments.*

A number of banks became so deeply enmeshed in the problems of their REITs that the financial integrity of those banks was undermined, and a number of large banks were placed on the regulators' problem list.** In addition, even when the risks of real estate loans were assumed by an affiliate, rather than directly by the bank, there were serious implications for the bank.

For example, in 1974, Beverly Hills Bank Corp., a one-bank holding company, found itself in trouble when a real estate developer defaulted on a loan. Immediately after news accounts of the default, customers of the holding company's affiliated bank withdrew 15 percent of their deposits. As a result of this run on the bank, the Federal Reserve Board was forced to intervene, and the bank was ultimately sold to Wells Fargo, with a resulting loss of banking competition.***

* Wall Street Journal, October 15, 1981, at 1 Col. 6.

** "Citibank, Chase Manhattan on U.S. 'Problem' List," Washington Post, Jan. 11, 1976, at A1, Col. 2.

*** House Comm. on Banking, Currency and Housing, 94th Cong. 2d Sess., Financial Institutions and the Nation's Economy 268 (Book 1) (Comm. Print 1976).

The REIT experience clearly demonstrates the present-day relevance of the principles of the Glass-Steagall Act. Banks' ventures into this investment medium prove that the public will still invest in bank-sponsored investment funds in reliance on the reputation of the bank. It shows that, in the event there are problems with a bank's REIT, confidence in the sponsoring bank will be impaired because of the public association of the bank with the fund. It demonstrates that banks will give in to pressures to misuse their credit facilities to bolster the fortunes of their affiliates, and they are at least as likely as any money manager to invest in imprudent investments. Finally, the use of affiliates to engage in these activities does not alleviate the danger to the banks.

In short, the recent REIT experience proves again the wisdom of precluding banks and bank affiliation from activities that carry an unacceptable level of risk.

S. 1720, In Its Present Form, Will Exacerbate, Not Cure, Existing Problems

The Institute agrees that the Committee has identified a situation that Congress should address as promptly as possible -- the need for a comprehensive re-evaluation of whether the financial industry, and the federal regulatory systems which govern the industry, should be restructured. The interim solutions that have been proposed, however, are admittedly not the

comprehensive legislation that is needed.

Rather, S. 1720 is a concededly piecemeal approach to the problem, and it would defer, until next year, consideration of the most urgent problems and the most vital parts of the complete package of needed reforms.

What is needed is a comprehensive approach to a series of interrelated problems. The fragments of this kind of program offered for consideration this year will not cure existing problems but will, in fact, exacerbate them.

Further Concentration of Economic Power

We are submitting today for the Committee's consideration a research paper compiled by Lance Girton.* This research provides significant details on the present-day concentration of financial power in the hands of a relatively few money center banks, and the extent to which access to financial capital in the amounts needed by major corporations is now substantially controlled by a limited number of financial institutions.

The effect of that provision of the legislation now under consideration, which would authorize banks to organize

* Dr. Girton is a Professor of Economics at the University of Utah. A copy of Professor Girton's paper, "Concentration of Financial Power," is submitted herewith in Exhibit C.

and manage all types of mutual funds, will be to concentrate even further this economic power in the hands of a few large banks and bank holding companies. The reason for this is that only a relatively few banks -- the large banks which can afford the necessary personnel resources, data processing capability and other resources -- will be able to organize, sponsor and manage a mutual fund. Giving this authority to the vast number of banks, bank holding companies, savings and loan associations and even credit unions will not do a thing for their current problems.

Significantly, the savings and loan institutions -- the segment of the depository industry most in need of help -- has already recognized this danger. The 4,000-member U.S. League of Savings and Loan Associations has announced its opposition to bank entry into the mutual fund business, noting that it could put thrifts in a "terrible earnings squeeze."* The "opportunity" offered by S. 1720 to permit these institutions to enter the mutual fund business has correctly been perceived

* Allen Wade, Director of Public Affairs, U.S. League of Savings and Loan Association quoted in Cavits, "Glass-Steagall: The Lines Blur," Pension and Investment Age, Aug. 31, 1981.

correctly been perceived as is an illusory hope.* This feature of S. 1720 will worsen, not improve, their financial situation.

Regulatory Inequality; Lack of Investor Protection

The current economic problems that exist in the financial services industry could only worsen if the Congress were to enact a bill that would not provide for equal regulation and adequate investor protection. S. 1720 would, however, have exactly those adverse effects, since it would permit banks to deal in interests in mutual funds without being regulated as a "broker" or "dealer" under the Securities Exchange Act of 1934, as all other mutual fund sales personnel are.

Moreover, S. 1720 would not require bank advisers to bank mutual funds to register under the Investment Advisers Act, as must all other advisers to mutual funds. This disparity in regulation is troublesome in itself; but, far more important is the loss in investor protection that would result from a de-

* On Monday of this week, Treasury Secretary Regan was forced to seek the deferral of a scheduled increase in passbook interest rates because the thrifts' financial condition had worsened due to the sale of all-savers certificates. While these instruments were intended to help the thrifts, their effect was to draw \$3 to \$4 billion out of passbook accounts. See Wall Street Journal, October 19, 1981, at 8. The thrifts apparently recognize that they do not need another such "rescue."

cision to place bank mutual funds outside the existing body of law in this important respect.

Already, banks engage in a significant amount of securities-related activities which have escaped the investor protection features of the securities laws. Today, bank activities include an increasing amount of investment advisory and brokerage services for individual customers. In addition, banks promote and sell interests in commercial paper as well as in various forms of collective investment media that already directly compete with mutual funds, despite the fact that many of them may be of dubious legality. These latter activities include the sale of retail repurchase agreements and dealing in interests in common trust funds and pooled investment funds for retirement plans.

To the extent that banks are permitted to expand their securities-related activities, the jurisdiction of the SEC, the agency created by Congress to regulate securities activities, should be perfected, so that all bank securities activities are properly regulated. Of course, some may feel that the disclosure-oriented philosophy of the securities laws is out of tune with the theory of the banking laws, which has always provided a large measure of secrecy for the financial condition of banking institutions.

Indeed, some may wonder whether the applicability of strict standards of public disclosure to financially distressed thrift institutions will provide the stabilizing ef-

fect that those institutions are seeking. But, a policy of secrecy can no longer be justified if investors are to be asked to invest their money in new types of bank-related investments, which are not confined to traditional, conservative activities and are not protected by federal depository insurance. If depository institutions cannot comply with the normal responsibilities of public disclosure, they should forego both existing and proposed new securities activities that make such disclosure necessary and appropriate.

If the Glass-Steagall Act, enacted in 1933 and embodying banking policies that go back to the origins of the nation's banking system, is now thought to be obsolete, so are the exemptions for banks contained in the Securities Act of 1933, the Securities and Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act of 1940. All these exemptions found their rationale in the argument that banks were substantially barred from the securities business by the Glass-Steagall Act. Any repeal or modification of the Glass-Steagall Act should likewise modify or repeal these exemptions.

Although the Glass-Steagall Act effectively separated banks from most aspects of the securities business, subsequent events have again clearly demonstrated the need for strict

SEC regulation. Time and again, the banking industry has been brought to the brink of disaster through unregulated securities activities, including, as we have shown, such activities as retail repos, New York City debt securities, collective funds, and REITs. It is far less likely that the problems experienced by banks in connection with these activities would have occurred had they been fully subject to SEC regulation.

Unregulated securities activities of banks involve problems which should be dealt with in comprehensive legislation. Thus, any legislation that would expand bank securities activities must concurrently vest the SEC with full jurisdiction over all such activities -- including all bank-sponsored pooled investment funds, all bank investment advisory services, and all bank retail distributions of securities. The Institute has prepared legislative proposals to accomplish these important goals, which we are submitting to the Committee for its consideration. (Exhibit D).

Disparity Between Restrictions on Banks and Securities Firms

Another aspect of S. 1720 that demonstrates the need for a comprehensive review is the fact that the bill permits banks to engage in certain aspects of the securities business, while it retains all the restrictions against securities firms engaging in the banking business. The goal of a "level playing field" cannot be achieved through the bill's partial, and decidedly one-sided, abolition of selected prohibitions on competition.

Large banks and bank holding companies which have spearheaded the drive to modify or repeal Glass-Steagall have stressed recent developments in the securities industry, arguing that fairness requires that the Congress permit them to engage in securities activities, as was the case in the 1920s. The development of money market funds and the recent acquisition of securities firms by other enterprises are presented as the rationale for permitting banks to mass-merchandise interests in pooled investment funds and other securities to the public.

It is far from clear that these developments raise the competitive issues that the banks claim. Although certain banks have sought to characterize the expansion of bank securities activities as a matter of "survival," banks are prospering very well under the present legal structure. For example, recent data published by the Federal Reserve Board indicate that, while money-market funds were growing substantially during 1980, bank profits were at record levels.* It is also far from clear that the acquisition of securities firms by other businesses will have any material impact on banks,

* "Profitability of Insured Commercial Banks," Federal Reserve Bulletin, Sept., 1981 at 657.

and especially those large banks which have seized on these developments to argue that they should be permitted to become even larger by expanding into other lines of commerce.

What is clear, however, is that if Congress permits banks to expand their securities activities, it will not only be the securities industry, but also small banks and savings and loan institutions, that will be materially injured. Furthermore, the ability of giant banks to offer expanded securities services and products will have a particularly devastating impact in light of the fact that securities firms will be unable to compete with banks in the banking business.

The proposals made by the large banks for expansion into the securities industry is, in short, a legislative one-way street. Banks would continue to enjoy a banking monopoly, while exploiting the relationships with their banking customers to develop and enhance their securities business. Economic studies, such as the study conducted by Professor Girton which we are submitting today, show that banks which offer multiple services are uniquely able to capture and retain the favor of their banking clients as customers for their non-bank services. Large banks freely admit this practice.*

* See Wall Street J., Oct. 15, 1981, at 1, col. 6. In this article, an officer of Continental Illinois Corp. and referred to the bank's loan tactics as "part of an overall strategy." He explained: "We package them up and get other fee-related business, and I always remind customers what I did for them."

Thus, to prevent the creation of a gross competitive imbalance, it is imperative that any modification of the Glass-Steagall Act be coupled with legislation that would enable securities firms to obtain the full banking powers enjoyed by national banks. The Institute has developed legislative proposals to accomplish this goal, which we are submitting to the Committee for its consideration (Exhibit E), and we suggest that our proposals be studied in the context of a general consideration of the impact of various reform proposals, so that a comprehensive legislative package can be developed.

Interstate Banking Restrictions

An additional problem area is posed by the McFadden Act and the Douglas amendment, which generally prohibit banks and bank holding companies from operating banking institutions in more than one state.

The existing restrictions on geographical expansion have led to the development of a nationwide correspondent system of banks through which the largest banks provide various services to smaller banks and in turn to their customers. The large banks have made it clear that, if the Glass-Steagall Act is modified or repealed, their existing correspondent relationships will be used to distribute securities products and services through this well-established chain of local banks. In each community, these securities activities will be linked to the banking services provided by local banks to their banking customers.

Thus, modification or repeal of the Glass-Steagall Act will give the large banks a major competitive advantage over traditional securities firms -- an advantage which will exist even if securities firms are permitted to hold a bank charter in a single state. As new entrants into the banking business, securities firms would be outside this correspondent system, which has grown in the protectionist shelter of the McFadden Act. This competitive disadvantage can only be ameliorated by permitting securities firms to engage in multi-state banking activities or to acquire banks across state lines.

Modification or repeal of the Glass-Steagall Act will also favor large banks with their correspondent networks over smaller banks. Small banks possess neither the capital nor the expertise to engage in the securities business and will immediately be put at a competitive disadvantage. In order to rectify this imbalance, regional banks, who so desire, should also be permitted to engage in banking activities across state lines, and to acquire or merge with out of state banks in order to compete successfully in the securities business against the large banks. Therefore, the McFadden Act must be repealed if changes are made in the Glass-Steagall Act. There is no other way that the Congress can avoid the competitive inequities that will result from piecemeal tinkering with one regulatory statute at a time.

Notions of maintaining a "level playing field" do not readily comport with the tremendous competitive advantage that would be conferred by letting some banks get a head-start in interstate operations in areas in which they are able to compete. This is particularly true since other, smaller banks, which would have to engage in interstate competition through other means, must wait until at least next year for Congress to study the issue and determine the basis on which such competition will be permitted.

A far better approach to this subject would be to consider, at the outset, and on a comprehensive basis, the extent to which there is a continued need for interstate banking restrictions before partially opening that door to some competition that only some large banks will be able to pursue.

Piecemeal changes in Glass-Steagall can well bring about the destruction of small banks and of an independent securities industry, not because that industry is inherently unable to compete effectively, but because the large banks will continue to enjoy the privileged sanctuary of protectionist legislation -- sheltering from competition the commercial banking function which is essential to industry and commerce -- as they reach out to dominate other financial businesses whose products they can then offer on a tie-in basis.

Conclusion

The Institute believes that there should be no legislative changes in Glass-Steagall until the Congress addresses the

issues of adequate protection of the investing public and competitive equality. The basic changes needed in the regulatory system which governs the nation's financial structure cannot safely be accomplished as the result of a few weeks' hearings. Rather, changes that will serve the Nation well in the long run must be carefully thought out, and can only be accomplished through the diligent efforts of all concerned segments of that industry and of its regulators.

This work should begin immediately. It will be a difficult task, but the Committee will have the full cooperation of the Institute in seeing it through.

RESTRUCTURING THE FINANCIAL SERVICES INDUSTRY:

THE NEED FOR A COMPREHENSIVE REVIEW

AN ANALYSIS
BY
THE INVESTMENT COMPANY INSTITUTE

"And there is a larger interest, that of depositors and of the National Government, which requires that the bank shall be conducted as a bank pure and simple and not as a promoting agency of speculative investment companies."

- Opinion of the Solicitor General (1911)

"It was perhaps something of an accident that the corporations which have obtained power to administer trusts are banking institutions. There is no necessary connection between the business of banking and the business of administering trusts. Indeed, many difficulties have arisen from the attempt to combine these two powers."

- Austin Scott (1936)

"The great objectives of banking regulation are controls over the flow of credit in the monetary system, the maintenance of an effective banking structure, and the protection of depositors. These objectives neither utilize the same tools nor achieve the same ends as investor protection. The purpose of disclosure is to place the investor in a position to make an informed judgment on the merits of a security, and to provide a basis for comparing that security with others issued by companies in the same or different industries. Essentially this purpose is achieved through the furnishing of financial information which provides a uniform pattern of reporting. To say that bank regulation renders this disclosure philosophy unnecessary is to say that bank regulation is an effective substitute for the free exercise of an investor's judgment. Controls which protect against embezzlement and which assure adequate reserves serve important objectives but not the objective of informed investment. To hold otherwise would be to imply that, because of such regulation, bank securities are, without more, worthy investments."

- William Cary, Chairman
Securities and Exchange
Commission (1963)

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"The Glass-Steagall Act reflected a determination that policies of competition, convenience or expertise which might otherwise support the entry of commercial banks into the investment banking business were outweighed by the 'hazards' and 'financial dangers' that arise when commercial banks engage in the activities proscribed by the Act."

- Investment Company Institute
v. Camp 401 U.S. 617, 630
(1971)

"It would be anomalous if all financial institutions offering investment advice to the general public, whether directly or through publicly-solicited individual advisory relationships or indirectly through publicly-solicited collective investment management arrangements like investment companies, were not subject to the same regulatory requirements, the same fiduciary responsibilities and the same degree of enforcement presence."

- Harold Williams, Chairman
Securities and Exchange
Commission (1979)

"The need to consider comprehensive legislation is a result of steadily increasing competition within the financial services industry which has made existing laws and regulations obsolete in many cases. . . . Revisions must be made in the financial system's structure to accommodate the changes which have occurred."

- Senator Jake Garn (1981)

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- Appendix G, Draft Legislation

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INTRODUCTION

A major and significant piece of proposed legislation affecting the integrity of this country's regulation of financial institutions, S. 1720, recently was referred to the Senate Committee on Banking, Housing and Urban Affairs. The concepts embodied in this bill -- which include the removal of century-long restraints on securities activities by commercial banks -- demand careful reconsideration of established concepts and principles of competition and investor protection in the financial services industry. In an effort to enhance constructive review of S. 1720, the Investment Company Institute (the "Institute"), on behalf of the mutual fund industry it represents, has prepared this position paper.

Constructive review of S. 1720, however, requires recognition of the fact that the bill seeks to accommodate two rather diverse, and potentially conflicting, objectives. One such objective is the perceived need to provide far-ranging and long-lasting relief from the "serious financial problems" of a troubled savings and loan industry.* Wholly unrelated to the financial stability of savings and loans, however, is the other stated objective of this legislation -- comprehensively to revise the rules governing competition within the

* 127 Cong. Rec. S 11254 (daily ed. Oct. 7, 1981)...

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financial services industry, in order to permit greater flexibility, foster greater competition among all segments of the industry, and repeal existing competitive restrictions.

To the extent that the situation of savings and loan institutions requires immediate attention, S. 1720 most assuredly deserves prompt consideration. But, to the extent that S. 1720 is also premised on the desire to effect a comprehensive restructuring of the rules governing competition between financial institutions, prudence and caution should be the watchwords.

Apart from a basic lack of necessary data to justify some of the changes the bill would effect, it is likely that the bill will actually impair the financial stability of the very institutions Congress seeks to promote. Moreover, even leaving aside questions of the financial efficacy of troubled savings and loan institutions, the impact of S. 1720 on financial services competition is problematic, and requires thoughtful review not only of what S. 1720 would accomplish, but perhaps more importantly, what S. 1720 would not accomplish.

Thus, S. 1720

- is not comprehensive;
- is not predicated upon any analysis of measures necessary to avoid current and past abusive practices employed in bank securities activities;

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- would not subject existing or proposed bank securities activities to regulation necessary to protect the public; and
- would not remove impediments to competition, but rather, would erect artificial barriers to meaningful competition, by unfairly denying to the securities industry the minimum tools necessary to compete effectively with the new banking-securities conglomerates that S. 1720 would spawn and foster.

The Institute believes that a firm and comprehensive factual and policy predicate should be developed before Congress considers adopting S. 1720.

- Summary of Position

For almost twenty years, large banks and bank holding companies, seeking to take advantage of their unique relationships with their banking customers and their correspondent networks, have sought to expand their activities in the securities field by repealing historic national policies designed to confine banking institutions to traditional banking services. To date, the Congress and the Courts have wisely, and consistently, rejected these efforts.

The conflicts of interest and the unsafe and unsound practices which have occurred when banks have engaged in the retail securities business have repeatedly placed the Nation's economic system in jeopardy. Even the narrowly circumscribed securities-related activities in which banks have engaged since the enactment of the Glass-Steagall Act in 1933 have

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caused substantial disruptions in the normal banking operations of major banks, and have placed large sums of public savings at substantial risk, without adequate safeguards or even public disclosure of such risks.

While all the major concerns and conditions which caused the Congress to enact the Glass-Steagall Act (and its antecedents) continue to exist today, a number of business and technological developments may require that new legislation be devised to accommodate, rationalize and harmonize these developments. At the same time, however, it is necessary to reinforce the protections to the public from abuses arising from unregulated bank securities activities and to prevent unfair competition and concentration of economic power in the hands of a few giant banking institutions.

Thus, any realignment of services that expands bank securities activities must also be accompanied or preceded by a realignment of the existing regulatory structure, to provide appropriate protections to bank investors and depositors. Moreover, the very complications that initially dictated a separation of commercial banking from traditional securities activities demand that, if changes are to be effected, they should not be authorized by piecemeal legislation which would permit banks to continue their exclusive government franchise to conduct the business of banking and

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thus aggravate the conditions which already give them a dangerous and an unfair advantage over all other financial institutions.

But, before any changes are made posing the attendant danger of "chaos in the banking system,"* legislation implementing such changes should be fashioned around a clear recognition that, time and again, the banking industry has been brought to the brink of disaster through those unregulated securities activities in which banks have engaged.

The problems of bank-related Real Estate Investment Trusts ("REITs") during the 1970's, for example, caused a substantial drain on banking institutions and large liabilities to their bank sponsors, which were involved in numerous conflicts of interest in the operation of these companies. It is important to note that even though many of these REITs were sponsored by an affiliate of the bank, rather than by the bank itself, it was the bank that was injured.

Similarly, the activities of bank underwriters of New York City obligations brought a major segment of the country's banking system close to disaster in view of the massive potential liabilities stemming from questionable distribution activities and bank conflicts of interest. The REIT and

* "Regan Outlines Deregulation Plan for Banks," Wall Street Journal, Oct. 16, 1981, at 2, col. 2 (interview with Treasury Secretary Donald Regan).

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New York City problems could have been prevented had these bank securities activities been subject to appropriate SEC regulation.

But these are not isolated occurrences. Currently, banks and other depository institutions have sold \$14 billion of so-called retail repurchase agreements which are uninsured debt obligations of the issuing banks.* Under appropriate SEC supervision, depository institutions issuing these obligations would have been compelled to disclose their true financial condition to investors who remain unaware of the very substantial risks involved in purchasing the debt obligations of issuers that are experiencing severe financial difficulties. But the bank exemptions in the federal securities laws have resulted in an absence of full and fair disclosure.

Only last week, it was reported that the ICU Government Securities Program, a bank common trust fund organized for credit union investors, was "technically insolvent" as a result of portfolio valuation practices that would not have been permitted had the Fund been subject to the federal securities laws.

* Federal Reserve Rel. H.6, Money Stock Measures and Liquid Assets, Oct. 9, 1981: "Small denomination (retail) RPS -- estimated at \$12.6 billion on a twelve month average basis and \$14.0 billion on a month-end basis in September". Table, col. "M3," note 6.

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Thus, the problem with the Glass-Steagall Act is not the extent to which it has restricted bank securities activities, but rather, the extent to which it has indulged (or, through lax enforcement, has been permitted to indulge) bank desires to expand into unwarranted securities activities. If legislation is desired to expand bank securities activities, that legislation should concurrently vest the SEC with full jurisdiction over all such activities -- including all bank-sponsored pooled investment funds, all bank investment advisory services, and all bank retail distribution of securities.

To the extent that banks are permitted to expand their securities-related activities, the jurisdiction of the SEC, the agency created by Congress to regulate securities activities, should be perfected so that all bank securities activities are properly regulated.

If the Glass-Steagall Act, enacted in 1933, is thought to be obsolete, so are the bank exemptions contained in the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. These exemptions were predicated upon Congress' understanding that banks were barred from virtually every facet of the securities business by the Glass-Steagall Act. Any repeal or modification of the Glass-Steagall Act requires a concomitant repeal of these exemptions.

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Large banks and bank holding companies that spearhead the drive to modify or repeal the Glass-Steagall Act have stressed recent developments in the securities industry, arguing that fairness requires that the Congress permit them to engage in securities activities, as was the case in the 1920s. The development of money-market funds and the recent acquisition of securities firms by other enterprises are presented as the rationale for permitting banks to mass merchandise interests in pooled investment funds and other securities to the public.

It is far from clear that these acquisitions, and the other developments in the securities industry to which the banks point, present the competitive issues that the banks claim. Although certain banks have sought to put the expansion of bank securities activities on a "survival basis," banks are prospering very well under the present legal structure. For example, recent data published by the Federal Reserve Board indicate that, while money-market funds were growing substantially during 1980, bank profits were at record levels.* It is also far from clear that the acquisition of securities firms by other businesses will have any material impact on banks and especially those large banks

* "Profitability of Insured Commercial Banks," Federal Reserve Bulletin, Sept., 1981, at 657.

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Moreover, what is clear is that, if Congress permits banks to expand their securities activities, it will be the securities industry, as well as small banks and savings and loan institutions, that will be materially injured. The ability of giant banks to offer expanded securities services and products will have a particularly devastating impact, in light of the fact that securities firms will be unable to compete with banks in the banking business.

The proposal made by the large banks for expansion into the securities industry is, in short, a legislative one-way street. Under current proposals, banks could continue to enjoy a banking monopoly while exploiting the relationships with their banking customers to develop and enhance their securities activities. Economic studies show that banks which offer multiple services are uniquely able to capture and retain the favor of their banking clients as customers for their non-bank services.

Thus, to prevent the creation of a gross competitive imbalance, it is imperative that, if a basis is developed to support any modification of the Glass-Steagall Act, such a modification should be coupled with legislation that would

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enable securities firms to obtain the full banking powers enjoyed by national banks.

But, even conferring such banking powers on securities firms would not suffice to alleviate the competitive dislocations the large banks would achieve under S. 1720 in its current form. An additional problem is posed by the McFadden Act and the Douglas amendment, which generally prohibit banks and bank holding companies from operating banking institutions in more than one state. These restrictions on geographical expansion have led to the development of a nationwide correspondent system of banks through which the largest banks provide numerous services to smaller banks and in turn to their customers. As was recently recognized:

Correspondent relationships with "country banks" provide [major banks] another captive market. Major banks offer their correspondents services such as check clearing, loan participations, lines of credit and investment advice in return for deposit balances. A natural allegiance to the respondents arises from this relationship *

As has been made clear by the large banks, if the Glass-Steagall Act is modified or repealed, these correspondent relationships will be utilized by the large banks to distribute their securities products and services through their

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Thus, repeal of the Glass-Steagall Act will give the large banks a major competitive advantage over traditional securities firms -- an advantage which will exist even if securities firms are permitted to exercise bank powers in a single state. As new entrants into the banking business, securities firms would be outside this correspondent system which has grown in the protectionist shelter of the McFadden Act. This competitive disadvantage can only be ameliorated by permitting securities firms to engage in multi-state banking activities or to acquire banks across state lines.

Repeal of the Glass-Steagall Act will also favor large banks with correspondent networks over purely regional banks. These banks possess neither the capital nor the expertise to engage in the securities business, and will immediately be put at a competitive disadvantage. In order to rectify this imbalance, regional banks who so desire should also be permitted to engage in banking activities across state lines, and to acquire or merge with out-of-state banks in order to compete successfully in the securities business against the large banks.

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well-established chain of local banks. In each community, these securities activities will be linked to the banking services provided by local banks to their banking customers.

Thus, repeal of the Glass-Steagall Act will give the large banks a major competitive advantage over traditional securities firms -- an advantage which will exist even if securities firms are permitted to exercise bank powers in a single state. As new entrants into the banking business, securities firms would be outside this correspondent system which has grown in the protectionist shelter of the McFadden Act. This competitive disadvantage can only be ameliorated by permitting securities firms to engage in multi-state banking activities or to acquire banks across state lines.

Repeal of the Glass-Steagall Act will also favor large banks with correspondent networks over purely regional banks. These banks possess neither the capital nor the expertise to engage in the securities business, and will immediately be put at a competitive disadvantage. In order to rectify this imbalance, regional banks who so desire should also be permitted to engage in banking activities across state lines, and to acquire or merge with out-of-state banks in order to compete successfully in the securities business against the large banks.

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Therefore, if changes are made in the Glass-Steagall Act, the McFadden Act should be repealed. There is no other way that the Congress can avoid competitive inequities that will inescapably flow from piecemeal tinkering with one regulatory statute at a time.

Piecemeal changes in the Glass-Steagall Act can well bring about the destruction of regional banks and of an independent securities industry, not because that industry is inherently unable to compete effectively, but because large banks will continue to enjoy the privileged sanctuary of protectionist legislation -- sheltering from competition the commercial banking function which is essential to industry and commerce -- as they reach out to dominate other financial businesses whose products they can then offer on a tie-in basis.

For these reasons, the Investment Company Institute believes that there should be no legislative changes in the Glass-Steagall Act unless and until the Congress first addresses and resolves issues of adequate protection of the investing public and competitive equality.

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THE GLASS STEAGALL ACT

Passage of the Glass-Steagall Act in 1933 reflected the conclusion of Congress that the mix of commercial banking and securities activities was so rife with conflicts of interest that it should not be permitted.* Before lifting this ban, Congress should carefully consider not only the events that led to its imposition, but whether the policies embodied in the Act are as necessary today as they were in 1933.

- Background of the Glass-Steagall Act

The National Bank Act of 1864, which granted national banks limited and specified powers, was consistently interpreted to prohibit completely national banks from underwriting or dealing in non-Government securities.** Such was the case until the early 1900's, when the Comptroller of the Currency reinterpreted the Act to permit national banks to underwrite and deal in debt securities. Nevertheless, even the Comptroller concluded, in 1902, that the National Bank Act did not permit national banks to participate in the underwriting and distribution of equity securities.***

* See generally Investment Company Institute v. Camp 401 U.S. 617, 629-633 (1971).

** Public Policy Aspects of Bank Securities Activities: An Issues Paper, U.S. Department of the Treasury, Appendix, at 2, (Nov. 1975).

*** Redlich, The Molding of American Banking-Men and Ideas, Volume 2 at 389, 393 (1951).

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An opinion issued by the Solicitor General on November 6, 1911, and concurred in by the Attorney General, has particular relevance for the issues being debated today, seventy years later. Pointing out that national banks have always been considered to be limited to those powers expressly granted to them, the opinion held that national banks are precluded from organizing, underwriting, or investing in the stock of other companies. The opinion stated:

"There is a larger interest, that of depositors and the National Government, which requires that the bank shall be conducted as a bank pure and simple and not as a promoting agency of speculative investment companies.*

In order to avoid these legal prohibitions on their securities activities, banks resorted to the now-familiar device of creating non-bank affiliates. There followed the familiar pattern of the bank regulatory authorities not only failing to enforce the existing restrictions, but lobbying on behalf of the commercial banking industry completely to break down the historic separation of commercial banking and the securities business.

These efforts on behalf of the banking industry eventually resulted in the passage of the McFadden Act in 1927,

* Opinion of Solicitor General Lehmann, November 6, 1911, quoted in 75 Cong. Rec. 9899, 9902 (1932).

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which permitted national banks to underwrite securities to the extent authorized by the Comptroller. The Comptroller soon granted national banks extensive authority to underwrite both debt and equity securities.*

Only six years later, Congress brought the banks' investment banking activities to an abrupt halt through enactment of the Glass-Steagall Act. An examination of what happened during the six year "window" during which commercial banks were permitted to engage in the securities business provides ample justification for Congress' conclusion that the experiment in expanded bank activity had been a grave mistake which should not be repeated.

The hearings that preceded enactment of the Act demonstrated that "commercial banks in general and member banks of the Federal Reserve System in particular had both aggravated and been damaged by the stock market decline, partly because of their direct and indirect involvement in the trading and ownership of speculative securities."** The hearings revealed that banks had promoted their securities affiliates through loans and through purchases of securities from these

* Perkins, "The Divorce of Commercial and Investment Banking: A History," 88 Banking Law Journal 483, 494 n. 27 (1971).

** Investment Company Institute v. Camp, 401 U.S. 617, 630 (1971).

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affiliates, either for the banks' own accounts, or on behalf of trusts under bank management. Bank loans were used to promote securities affiliates in various ways. Banks made loans to their own affiliates to finance underwriting activities and financed customers' purchases of securities underwritten by bank affiliates. Funds were also loaned to corporations that agreed to use bank affiliates for underwriting their securities issues.

Banks were found to have placed additional funds at risk in order to protect securities affiliates whose collapse would threaten the bank's stability or diminish public confidence in the bank. Banks also purchased securities from their affiliates in order to assure the success of an underwriting or to relieve the affiliate of excess holdings.

In general, the abuses and conflicts of interest that arose in connection with the combination of banking and securities activities, and which led to enactment of the Glass-Steagall Act, fell into the following categories:

- Banks invested their own assets in imprudent securities investments
- Banks succumbed to promotional pressures, such as the pressure to make bank credit facilities available to companies in whose securities the bank had invested or become involved
- Bank depositors made investments in reliance upon the relationship between the bank and its affiliate;

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- Banks traded upon their reputations for prudence and financial integrity to make sales of securities;
 - Banks were tempted to make loans to customers where the loan could facilitate the purchase of securities;
 - Banks succumbed to conflicts of interest between their promotional interests as investment bankers and their obligations as commercial bankers to make disinterested investment and lending decisions; and
 - Bank trust departments were used as a dumping ground for excessive or undesirable securities holdings.*
- Relevance of the Policies of the Glass-Steagall Act Today

Congress determined to keep commercial banks and their affiliates out of the securities business largely because it believed that the promotional incentives of the securities business, and a securities firms' pecuniary stake in the success of a particular investment opportunity, were destructive of disinterested commercial banking and of public confidence in the commercial banking system.**

Any amendment to the Glass-Steagall Act should not defeat or undercut the original purpose of the Act by introducing the banking industry to new risks, or by endangering

* Investment Company Institute v. Camp, 401 U.S. 617, 629-633 (1971). See also, Hearings before a Subcommittee of the Senate Committee on Banking and Currency, 71st Cong., 3d Sess. Part 7 at 1063-64 (1931).

** Investment Company Institute v. Camp, supra, 401 U.S. at 634.

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public confidence in the stability and impartiality of the banking community. Moreover, today, with segments of the depository industry in delicate financial condition, it is particularly important to act with caution in this most sensitive area.

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CONSEQUENCES OF BANK EXPANSION INTO THE MUTUAL FUND BUSINESS

Before permitting banks to expand their activities into the mutual fund field, as would be accomplished by S. 1720, Congress must take account of the consequences that would attend such a major change in national policy.

- Increased Concentration of Economic Power

Bank entry into the mutual fund business (including common stock and bond funds, as well as money market funds), raises serious questions whether the banks' new activities would lead to, or exacerbate, an undesirable concentration of economic power. Such concentration could take two forms: conglomerate and horizontal. Conglomerate concentration could result in instances where a single large bank provided a broad range of financial services. Horizontal concentration could occur if the number of firms providing a particular investment service was reduced. Horizontal concentration could result from bank entry into the mutual fund business, for example, where the entry is accomplished through merger or acquisition of existing mutual fund firms, or through the attrition of competitors that provide the same services that the banks will offer.*

* Public Policy Aspects of Bank Securities Activities: An Issues Paper, U.S. Department of the Treasury, at 14, (Nov., 1975).

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Either type of concentration would have undesirable results. An increase in securities-related activities by the banking industry could reinforce the trend toward concentration of corporate ownership by a small number of very large institutions. For example, at the beginning of 1979, institutions held approximately 43.4 percent of the market value of all common and preferred stock outstanding.*

Recent studies indicate that institutional investor holdings are concentrated in the shares of relatively large companies to an extent greater than can be explained by the size of those companies relative to the market as a whole.** There is also a considerable degree of commonality among stocks in which institutional portfolios are heavily invested. The stocks being favored are those of the largest corporations, such as IBM and General Motors.*** Moreover, a recent study by Girton, of the University of Utah, contains the following sobering conclusion with respect to bank concentration:

* L. Girton, Concentration of Financial Power at 4, (unpublished 1981). Attached hereto as Appendix A. (Prof. Girton is a Professor of Economics at the University of Utah).

** H. Rosenberg, "Institutional Investors: Holdings, Prices and Liquidity", Financial Analysts Journal 30, 55 (March/April, 1974).

*** L. Girton, Concentration of Financial Power, supra, at 9.

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A view that emerges from the analysis of stock ownership patterns and interlocking directorate relationships among the six largest New York banks and the largest 10 banks in the country is that these financial institutions are interrelated to an extent that casts doubt on the wisdom of treating them as totally independent institutions. Banking in the United States would seem to be even more concentrated functionally than standard analysis would suggest.*

Centralization of investment activity of this type has the potential to distort the valuation function of the stock market, and may disproportionately allocate capital to various businesses. For example, some analysts believe that institutional investors tend to favor the stock of a limited number of "first tier" companies to the detriment of less favored "second-tier" firms, which are generally the smaller and emerging companies.** An increase in the role of banks as institutional investors could produce results that are presently unquantifiable. Such a potential influence on the capital markets should be the subject of a thorough analysis.

Another type of concentration could occur in the form of the expansion of banks' multiple business relationships. Studies indicate that banks tend to have more types of

* Id. at 23.

** See, e.g., L.D. Solomon, Institutional Investors: Stock Market Impact and Corporate Control, 42 George Washington L. Rev. 761 (1974).

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contacts with the same customer than do non-bank institutions. The SEC's Institutional Investor Study revealed the following information with respect to the frequency of these contacts:

NUMBER OF RELATIONSHIPS BETWEEN INSTITUTIONS
AND 288 SAMPLE COMPANIES*

	Share- holdings	Creditor	Depository	Employee Ben. Plan Manager	Personnel
Banks (49)	5324	1581	2133	285	297
Investment Adv. (69)	2748	67	0	45	91
P & L Insurance (21)	640	43	0	0	69
Life Insurance (22)	598	506	0	96	113

The more recent study by Professor Girton concludes that banks' stock investments are closely related to other ties: personnel interlocks, pension plan managerial relationships, and lending or deposit relationships.**

This multi-service concentration was described, with concern, by Richard McLaren, then Assistant Attorney General

* Source, Institutional Investor Study Report, Vol. 5 at 2735, 2741. (Washington, D.C.: U.S. Government Printing Office, 1971).

** L. Girton, Concentration of Financial Power, supra, at 14.

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in charge of the Antitrust Division, in testimony before Congress in 1970:

Bank expansion in other areas permits the carry over of economic power into such endeavors. There is, of course the obvious danger of overt reciprocity or tying arrangements, as well as general favoritism of bank affiliates, particularly in times of tight money. Also, and perhaps more important in terms of the need for present legislation, there are dangers which are of a more structural nature -- adverse competitive effects that would tend to develop naturally without actual overt use of the economic power carried over from the banking sphere.

* * * *

This can be illustrated by an example. A potential loan applicant might voluntarily place his casualty insurance business with a bank-affiliated insurer in hopes of improving his chances for a mortgage loan on the insured property on favorable terms. This would have the same effect as a coercive tie-in. Competition in the tied product insurance would be lessened to the extent that customers no longer purchased it entirely on its own economic merit. One such merger might well trigger others and as a pattern of such bank-insurance affiliations developed market foreclosure in the tied field would become more and more serious.

* * * *

This structural problem is intensified because present antitrust remedies appear inadequate to deal directly with it. There simply is no illegal practice or conduct for a court to enjoin. Hence, we must concentrate on avoiding a structure which gives rise to such effects.*

* One Bank Holding Company Legislation of 1970, Hearings Before the Senate Committee on Banking and Currency, 91st Cong., 2d Sess. 239-40 (1970) (emphasis added). See also Mr. McLaren's remarks before the House Committee: The Bank Holding Company Act Amendments: Hearings Before the House Committee on Banking and Currency, 91st Cong., 1st Sess. 91-92 (1969).

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The financial community is also well aware of the prediction of the banks to convert customers into multi-service customers. For example, a former Continental Illinois National Bank employee reported that pressure is commonly applied to commercial customers in order to accomplish such conversions. The commercial lending officer needs only mention to the potential corporate customer how their full service bank would "love" to manage his pension fund, and "[t]he executives get the picture pretty quickly."* Only last week, it was reported that an officer of the same bank referred to the bank's loan tactics as "part of an overall strategy." He explained: "We package them up and get other fee-related business, and I always remind customers what I did for them."**

A recent editorial in Pensions & Investments, a bi-weekly newspaper published for members of the pension industry, reflected the same concern. Recognizing that bank managers of pension funds have "languished near the bottom of the investment performance tables for almost a decade," the editorial noted that "[m]any observers suspect that some

* Wall Street Journal, Jan. 7, 1975 at 1, col. 6.

** "Behind Homely Image of Continental Illinois Is An Aggressive Bank," Wall Street Journal, Oct. 15, 1981, at 1, col. 1.

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large banks have maintained their pension clients over the past eight or nine years mainly because they have commercial ties with those clients.** The editorial further expressed the concern that "clients fear corporate relations will be jeopardized if they fire the banks as pension fund managers."

Indeed, in a recent speech before the Western Trust Conference, Richard W. Heiss, President of the American Bankers Association Trust Department, proclaimed that one of the benefits which banks hoped to gain through their entrance into the mutual fund business would be just such a multi-service role. According to Heiss, the banks' new mutual fund business would be:

[A]n entree for affluent, non-bank customers into the trust department where additional bank and trust products can be promoted and a total banking relationship enhanced.**

Bank entry into the mutual fund business thus appears to have a significant potential to contribute to an increased concentration of economic power in the hands of banks -- particularly the large money center banks. This potential is

* "Investing Solely in Interest of Beneficiaries", Pensions & Investments, Jan. 1, 1979 at 6.

** R. Heiss, A View of the Current Legislative and Regulatory Environment Facing the Trust Industry, Address before the Western Trust Conference, San Diego, California, at 22 (Sept. 17, 1981).

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of particular concern today, in view of the contraction of the banking industry that has resulted from the financial problems experienced by the thrifts and the smaller commercial banks. Moreover, the thrift industry assistance provisions of S. 1720 could also result in increased concentration in the banking industry. Therefore, it may not be advisable to proceed with Glass-Steagall Act changes until the banking industry has stabilized from its current and anticipated contractions.

- Impact on the Banking System

- The Condition of the Banking System

The large banks allude to the Glass-Steagall Act's prohibition on banking institutions' offering their own mutual funds, particularly money market mutual funds ("MMMFs"), as the reason why segments of the banking industry are in financial difficulty. They imply that, if banking institutions were permitted to offer mutual funds, the banking industry's problems would be solved.

Neither assertion is correct. As Administration officials recently testified, thrift institutions and, to a lesser extent, small commercial banks, have experienced problems in recent years because the structure of their asset and liability portfolios makes it difficult for them to cope with the prolonged high interest rates brought on by

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the prevailing high rates of inflation.* Distortions and uncertainty caused by this inflation have forced these institutions to use increasing amounts of short-term deposit liabilities with interest rates that vary with market rates, in order to make long-term mortgage loans or to carry long-term mortgages made in prior years, generally at the lower rates then prevailing. As a result, these banks paying more for their liabilities than they are earning on their assets, leading to operating losses and erosion of capital. The problem, therefore, is the current unavailability to banks of cheap funds.

Money-market mutual funds are neither the cause of, nor the cure for, this situation. For example, during 1980, households placed an additional \$125 billion into time and savings deposits in depository institutions, an amount greater than the total assets of the MMMF industry at that time.** By

* Statement of Donald T. Regan, Secretary, Department of the Treasury before the Senate Committee on Banking, Housing, and Urban Affairs, April 28, 1971 published in Competition and Conditions in the Financial System: Hearings before the Committee on Banking, Housing and Urban Affairs, United States Senate 97th Cong. 1st Sess. at 31-33 (1981).

** Federal Reserve Board Division of Research and Statistics, Flow of Funds Account, Fourth Quarter 1980, at 7 (1981).

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contrast, the assets of the MMMF industry increased by \$29.2 billion in the same year.*

Deposits in savings institutions have shown a steady growth over the past 20 years; however, more recently, the character of these deposits has undergone significant change. Deposits have been shifted from low-yielding passbook-type accounts to six month and thirty month certificates and other deposits that are more expensive to savings institutions. This shift in the character of their own assets is the key to the depository institutions' problems, not the existence of money-market funds.

Ironically, a device intended by the Administration to assist thrift institutions, the all-savers certificate, has had a counterproductive effect, precisely because it has had the effect of drawing billions out of passbook accounts in just one week. As a result, Treasury Secretary Regan was forced to defer a scheduled increase in the passbook interest rate, noting that the thrift institutions' "costs" have increased substantially in the wake of "all-savers certificates.**" The proposal to permit banks to enter the mutual fund business would have this same effect.

* Id.

** "Regan, In Reversal, To Seek Delay in Rise of Passbook Interest Rates for Nov. 1", Wall Street Journal, Oct. 19, 1981, at 8, col. 2

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Inflation has not been a villain, but a benefactor, for the commercial banks, however. High interest rates have meant higher returns for this segment of the industry, according to recent statistics which indicate that 1980 was a year of record profits for the Nation's commercial banks.*

-- Potential For Further Injury

The precarious condition of some depository institutions is not a product of the existence of money-market funds, nor is that condition likely to be improved by S. 1720, which would permit depository institutions to offer MMMFs. Bank-sponsored funds will not provide banks with a source of inexpensive funds. Indeed, provisions which form the heart of the Investment Company Act would prohibit a fund sponsored by a bank from investing one penny in that bank's deposits.**

Rather, bank-sponsored funds are likely to draw deposits out of the banks' savings accounts -- precisely where funds are needed -- into a higher-paying investment vehicle. Moreover, given the operational economics of a MMMF, it is unlikely that more than a handful of the largest banks nationwide would be able to sponsor such a fund. A MMMF generally

* "Profitability of Insured Commercial Banks," Federal Reserve Bulletin, Sept., 1981, at 657.

** Investment Company Act of 1940, §17; 15 U.S.C. §80a-17 (1976).

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requires millions of dollars of assets to make economic sense in light of the costs of fund operation. These expenses include, among other things, sufficient computer capability and personnel with requisite industry and regulatory expertise.

Thus, small-to-intermediate size banks are unlikely to be able to commit the capital necessary to offer their own funds and are more likely to distribute a MMMF sponsored by one of the large financial center banks. As a result, deposits will not even shift from savings accounts at the smaller banks to higher yield accounts at the same banks; rather, the deposits will leave the bank entirely.

Significantly, the savings and loan institutions -- the segment of the depository industry most in need of help -- have already recognized this danger. The 4,000-member U.S. League of Savings and Loan Associations has announced its opposition to bank entry into the mutual fund business, noting that it could put thrifts in a "terrible earnings squeeze."* S. 1720 offers savings and loans and small banks only an illusory "opportunity," and the savings and loan

* Alan Wade, Director of Public Affairs, U.S. League of Savings and Loan Associations, quoted in Cavuto, "Glass-Steagall: The Lines Blur," Pension and Investment Age (Aug. 31, 1981).

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industry correctly perceives that this legislation could have deleterious effect on it.

-- Implications For Interstate Banking

It is clear that, if the bill is enacted, large banks will distribute their mutual funds through their networks of correspondent banks. Large bank entry into the mutual fund business thus raises major issues relating to the permissible extent of interstate banking, and suggests that S. 1720, while purporting to defer consideration of the modification of the McFadden Act until next year, may, in fact, result in a de facto revision of the McFadden Act immediately.

-- Risk of Overextension and the Danger of Bank Failures

It may be imprudent to permit banks to enter businesses that are characterized by significantly greater fluctuations in earnings than the business of banking at a time when the adequacy of bank capital is already under substantial pressure.

A key element of bank stability has always been a steady, dependable, source of revenue. Today's uncertain inflationary economic conditions are a particularly inappropriate environment in which to introduce the banking community to a business which is known to experience significant variations in operating results. Bank entry into the mutual fund-

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field might lead to an increase in bank failures and rescue missions and thereby result in decreased competition in the banking industry itself.

Banks may be tempted to take imprudent risks in their mutual fund activities in an effort to improve their overall performance. Overextension in an effort to bolster bank performance would not be a new phenomenon in the banking business. Indeed, numerous bank failures over the past ten years have resulted from similar efforts to shore up banking business profits by venturing into riskier fields. For example:

- The Hamilton National Bank of Chattanooga collapse was directly attributable to heavy loan losses it had acquired from one of the affiliates of its parent holding company.*
- The First State Bank of Northern California failed as the result of the Bank's overaggressive loan practices.**
- The Northeast Bank of Houston failed as the result of the Bank's over-extension in real estate loans.***
- The Franklin Bank of Houston failed as the result of over-extension in questionable real estate loans.****

* "A 'Problem' Bank Goes Under," New York Times, Feb. 22, 1976.

** "Fifth Bank Failure Announced by FDIC," Springfield Union, Springfield, Mass., May 26, 1976.

*** "Northeast Bank Bids to be Received Today," Houston Post, Jun. 5, 1976.

**** "Franklin, Tex.; Board Calls Bank Insolvent," American Banker, Mar. 26, 1975.

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- The First National Bank of Eldora failed as the result of speculation in the livestock market.*
- One of the factors in the failure of the Birmingham Bloomfield Bank was the Bank's investment of depositors' money in risky tax exempt bonds issued by obscure governmental units, which were not due to be paid for some 20 years.**

The largest bank failure in the Nation's history, the failure of the Franklin National Bank of New York, resulted in significant part from that Bank's effort to improve its earnings by entering a riskier, but potentially more lucrative, field. To recoup losses resulting from the overly-aggressive expansion of its loan portfolio, Franklin began to speculate in foreign currency and bond markets.

In one year, Franklin's securities holdings rose from \$499 million to \$825 million. To finance these securities activities, the Bank borrowed short-term, using federal funds, and employed repurchase agreements. When its situation worsened, Franklin executives resorted to inflating Franklin's earnings artificially, doctoring its books and issuing misleading financial statements.***

* "Eldora Bank Ordered Closed," The Des Moines Register, Oct. 6, 1973.

** Smith, "How Parsons Group Tactics Ruined Bank," The Detroit News, Feb. 14, 1971.

*** See, e.g., United States v. Gleason, 616 F.2d (2nd Cir., 1979). See also, Welles, "The Needlessly High Cost of Folding Franklin National," N.Y. Magazine, Nov. 18, 1974 at 71.

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Finally, the failure of the Eatontown National Bank was due precisely to one of the activities the Glass-Steagall Act seeks to prevent -- bank trading in securities for its own account. The Bank opened accounts with about 15 brokers and traded up to \$175 million of stocks. This practice resulted in losses of more than \$5 million for the bank, and led to its collapse.*

-- Increased Conflicts of Interest and the Danger of Bank Failures

New and more extensive conflicts of interest would attend bank entry into the mutual fund business. Even now, conflicts of interest have caused numerous bank failures.

For example:

- * The Citizens State Bank, Carrizo Springs, Texas, failed because of questionable loans made to bank insiders.**
- * The Tri-City Bank of Warren failed as a result of its extension of extremely large lines of credit to three of the four outside directors on its board, and to companies controlled by those directors.***

* "Failed Bank May Have Traded \$100 Million of Stocks With Over 12 Securities Firms," Wall Street Journal, Aug. 12, 1970.

** "Davis Loan Labeled as Tax Shelter," Dallas Times Herald, Jul. 25, 1976.

*** "3 Directors Had Large Credit Lines at Defunct Bank," Detroit Free Press, Oct. 2, 1974.

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- The American Bank & Trust Co. failed, in part, as a result of its extension of loans to businesses in which the chairman of the bank was a general partner, and to the bank's major shareholder, his family and businesses.*
- A factor in the failure of the Birmingham Bloomfield Bank was unsound banking practices, such as loans to bank insiders and their businesses.**
- The failure of the First Bank of Macon County was the result of self-dealing transactions, including the use of bank funds for personal use.***
- The First State of Bonne Terre's failure was the result, in part, of self-dealing transactions by officials of the bank.****
- Self-dealing transactions also contributed to the failure of the Delta Security Bank & Trust Co. in Ferriday, Louisiana.*****
- The Mount Zion Deposit Bank failed as a result of self-dealing transactions by bank officials.*****

* "High Risks, Concentrated Lending, Control Flaws Cited in NYS Report on Closed Am B&T," American Banker, Sept. 17, 1976.

** "FDIC Suit Reveals Birmingham Bank Deals," Detroit News, Mar. 7, 1972, at 5B.

*** "Macon Bank Liabilities Transferred," Alabama J., Jan. 29, 1978.

**** "U.S. Was Looking Askance at Bonne Terre Bank in '68," St. Louis Mo. Globe-Democrat, April 6, 1971.

***** "Report on Bank Goes to Guste," Times - Picayune, Feb. 1, 1973.

***** "Grant Bank Case Set Next Week," Frankfort State Journal, Jun. 24, 1976.

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- The Northern Ohio Bank failed as a result of self-dealing loans.*
- The failure of the Surety Bank & Trust Co., Wakefield, was caused by self-dealing transactions.**

Finally, the second largest bank failure in American history, the failure of the United States National Bank of San Diego, was caused by a series of self-dealing transactions involving the chairman of the Bank, his friends, relatives, business associates, and another corporation that he controlled. These transactions also involved loans in excess of federal limits and loans to executive officers. The Bank's chairman also maintained a secret account in the name of a subsidiary of one of his other companies, through which he directed money to finance questionable stock purchases.***

Bank entry into the mutual fund business would only increase the potential for conflicts and resulting bank failures. Moreover, as is demonstrated by the record of bank REIT activities, discussed infra (see page 86), this problem cannot be avoided, as has recently been suggested, by banks conducting securities activities through affiliates.

* "Six Bankers Loaned Funds to Themselves," Cleveland Press, Mar. 5, 1975.

** "Unannounced Examination Found Surety Shortages," The Christian Science Monitor, May 27, 1972.

*** "Smith Transactions Described for Court," San Diego Union, May 2, 1974.

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-- Increased Exposure For Federal Deposit Insurance

An increased likelihood of bank failures as a result of bank entry into the mutual fund business also has implications for the liability of the government, as the underwriter of the security of bank deposits. Before increasing the government's potential exposure as an insurer, it would be advisable to consider thoroughly the extent to which the potential liability would be increased. In the years 1970 to 1980, for example, the Federal Deposit Insurance Corporation disbursed \$5.345 billion to depositors in banks that had failed.* The current resources of the FDIC total \$12.6 billion.

- Impact on the Mutual Fund Industry

-- Advantages Bestowed By Bank Status

Because of their importance as financial intermediaries, banking institutions have enjoyed a variety of privileges and subsidies, which were granted by Congress in order to reduce the costs of financial intermediation. An issue which requires resolution before banks should be permitted to enter the mutual fund business is the extent to which the advantages which have been bestowed on banks to promote their banking

* Federal Deposit Insurance Corporation, 1980 Annual Report, p. 290, Table 122 (Number and Deposits of Banks Closed Because of Financial Difficulties, 1934-1980).

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functions should be available to provide a competitive advantage to banks in their nonbank activities.

These advantages are not insubstantial. Bank costs are reduced through federal deposit insurance, which serves to lower the rates of return required to attract investors, by making bank deposits up to prescribed levels virtually risk free. The favorable tax treatment accorded banks for interest expenses* and loss reserves** also effectively increases a bank's after tax income. In addition, banks have ready access to short-term funds at low cost through the federal funds market and the Federal Reserve Board's "discount window." The cost of banks' long-term capital also is lower as a result of federal and state restrictions on entry into the banking business and the readiness of the Federal Reserve Board and other banking agencies to provide low-cost credit to meet temporary liquidity problems.

Not only are banks subsidized through these advantages and privileges, they are also protected from competition. For example, limited entry into the banking business reduces

* Banks may deduct interest expenses incurred to hold tax-exempt municipal bonds. Rev. Rul. 61-222, 1961-2, C.B. 58.

** Although this provision is being phased out, banks may set up a reserve against future loan losses and deduct this reserve from gross income. I.R.C. §585; 26 U.S.C. §585 (1976).

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the competition for deposits, thereby decreasing the rates earned by depositors as against those that would prevail if there were free entry. Similarly, interest rate ceilings with respect to time deposits and interest prohibitions in connection with most demand deposits reduce price competition for deposits, since they enable banks to pay less than market rates for such deposits.

The cost of borrowed funds is also less for banks than for non-banks. A broker-dealer which had to compete with banks would be at a decided disadvantage due to this factor. Broker-dealers must depend on bank loans to provide margin loans for their customers and to carry securities during an underwriting. While banks can obtain funds at "wholesale," broker-dealers must borrow at "retail" -- one to two percentage points higher than the cost to banks.

-- Subsidization of Bank Affiliates

Another type of competitive advantage arises by virtue of the fact that non-banking enterprises affiliated with banks through bank holding companies can be subsidized by banking operations. This advantage will exist regardless whether non-banking activities -- such as securities activities -- are conducted by a bank affiliate rather than by the bank itself. The only solution would be legislatively imposed anti-subsidization standards.

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A ready example of the in the mortgage banking in lar to investment banking or "underwrite" mortgages chasers. Since bank hold of mortgage banking comp have found themselves ar ing with mortgage bank

Bank-affiliated fil tories -- their major their affiliated bank the Federal Reserve of Advance Mortgage competitive impact in Citicorp's exten

Another exampl dit union data pr highly competitive the major establ Power Unlimited ("ICCI"). Thre

* "Th... sition permit position signi 60 Fed. Res. 5

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third largest company in the credit union data processing industry in terms of the number of credit unions served.

The two Citicorp subsidiaries launched intensive advertising, promotion and sales campaigns, which emphasized their close relationship to Citicorp and Citibank and the financial resources and related financial services of these entities. Reportedly these Citicorp subsidiaries have priced their systems below that of most other competitors and have offered higher cost computer equipment for the price of lower priced equipment to entice the credit unions to purchase their systems.* In the cases where the competitor's system has features lacking in their own system, Citicorp subsidiaries have guaranteed to install these features at no cost to the credit union.**

Citicorp has also launched an intensive advertising and promotion campaign to attract credit unions to both ICCI and CPU, at costs far beyond the ability of the average data processor to match. At trade conventions, the Citicorp processors have very elaborate hospitality rooms and follow the

* Testimony of John N. Reardon, President, USERS Inc., before the Senate Committee on Banking, Housing, and Urban Affairs reported in Competition and Conditions in the Financial System: Hearings before the Committee on Banking, Housing, and Urban Affairs, 97th Cong., 1st Sess., 1285 (May 13, 1981).

** Id.

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practice of expensive entertainment of credit union personnel involved in purchasing decisions. In addition, ICCI has hired salesmen away from other companies and makes continual offers of double the base salary without regard to sales.*

As John N. Reardon, President of USERS, Inc., a competitor company, recently testified before Congress:

It is clear that the financial resources do not come from the earnings of the two subsidiaries, ICCI and CPU, but from Citicorp itself. Such heavy cross-subsidization from Citicorp and its regulated banking enterprises is severely damaging to small businesses trying to compete at increasingly lower and shrinking (or non-existent) profit margins. Citicorp seems to be taking the position that they will subsidize the losses until they achieve the major market share. Given the nature of the credit union data processing industry, this guarantees that several, if not most, of the smaller companies will be driven out of business.**

-- Uneven Regulatory Burdens

Banks would also enjoy a competitive advantage if they continue to be exempted from the federal securities laws, which, in the course of protecting investors and the integrity of the securities markets, impose compliance costs and burdens on participant firms.

For example, under S. 1720, banks in the mutual fund business would not be subject to requirements applicable to non-

* Id.

** Id.

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non-bank broker-dealers and investment advisers. These include, in the case of a brokerdealer registered with the SEC, and a member of the National Association of Securities Dealers, Inc. ("NASD"), periodic financial statement filings, periodic fees, books and records and minimum capital requirements, requirements for training, examination and bonding of employees, rules regarding the suitability of securities for a particular investor, rules governing the content of advertising materials, requirements for furnishing detailed confirmations of purchases and sales and periodic statements of account, contributions to the Securities Investor Protection Corporation, rules requiring full disclosure of information regarding securities sold to customers, general rules regarding the duty owed to customers which hold brokers to high professional standards and rules relating to the duty of broker-dealer principals to supervise their employees.*

S. 1720 would not subject banks rendering advice to mutual funds to registration with the SEC as investment advisers under the Investment Advisers Act of 1940, and would not have to comply with the attendant application, filing fee and books and records requirements.* Nor would S. 1720

* See generally, Wolfson, Phillips & Russo, Regulation of Brokers, Dealers, and Securities Markets (1977).

** See Investment Advisers Act of 1940 §202(a)(11), 15 U.S.C. §80b-2(11) (1976 which effectively exempts banks from the definition of investment adviser).

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subject banks to the usual regulatory and disclosure obligations under the Advisers Act, including a prohibition on unfair performance fees.

Thus, consideration of Glass-Steagall Act amendments must be coupled with an examination of whether a comprehensive restructuring and reallocation of the regulatory burdens and benefits of the banking business and the securities industry is necessary in order to achieve regulatory equality as part of a truly "level playing field."

Attached as Appendix B is a legislative proposal which would foster equality of regulation and enhance investor protections with respect to banks' mutual fund activities.

Need for Reciprocal Expansion of the Powers
of Mutual Fund Advisers

Expansion of banks' activities into the mutual fund business presents the question whether a reciprocal expansion in mutual funds' permitted activities is necessary in order to prevent further competitive imbalance. Thus, just as banking institutions would be permitted to enter the mutual fund business -- a competitive field heretofore occupied solely by investment advisers and their investment companies -- registered investment advisers to mutual funds should be afforded the opportunity to compete with banks in areas previously reserved to banks.

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An enhancement of the powers of mutual fund investment advisers to grant them the powers of national banking associations is an essential complement to new powers proposed to be granted to banking institutions. Moreover, the McFadden Act and the Douglas Amendment, which prevent banking institutions from conducting a banking business in more than one state, have led to the development of nationwide correspondent systems of banks through which the largest banks provide a variety of services to the smaller banks and their customers.* If the Glass-Steagall Act is modified or repealed, the large banks intend to utilize these correspondent relationships to distribute securities products and services through a chain of local banks.

Thus, if advisers were granted national banking association powers, they still would be shackled by restrictions on interstate banking activities which the big banks would be able to overcome through their correspondent system. In order to mitigate this major competitive advantage, it would be necessary to exempt advisers from the restrictions on nationwide banking which are imposed by the McFadden Act and the Douglas Amendment.

* See Mehle, supra, at 10.

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Attached as Appendix C is draft legislation which would provide for such a reciprocal enhancement of the powers of mutual fund advisers.

- Impact on the Public

-- Lack of Adequate Investor Protections

The division of statutory and regulatory authority which would result from S. 1720 presents numerous problems. For example, the Investment Company Act and the Advisers Act are complementary statutes, designed to protect investment company investors by requiring disclosure of meaningful information and by providing protection against conflicts of interest. The public requires the protection of all these measures when they invest in a bank-sponsored fund, just as much as they do when investing in a non-bank mutual fund.

Moreover, the public would also be benefitted if the system of regulation were administered by the only agency whose specific mandate is the protection of investors, and the only agency with more than 40 years of experience dealing with the problems of investment companies and investment advisers, the Securities and Exchange Commission. The public would also benefit if bank brokers and dealers were subject to the same high standards of training, experience, and conduct as are all other brokers and dealers in the securities industry. Again, the regulatory body best suited to insure

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that these standards are met would appear to be the SEC or the NASD, both of which have decades of experience in the field.*

While there are enough problems in excluding the SEC from its full role in connection with bank mutual funds, the situation is made still worse by virtue of the fact that regulatory responsibility is further fractionalized due to the split jurisdiction of the banking regulators.

The likely result of this division of responsibility will be inconsistent regulations with respect to functionally identical activities, not merely between the SEC and banking regulators, but among the different banking regulatory bodies themselves.** As a consequence, investors in funds subject to different agency oversight may be forced to rely not only on regulations that provide different degrees of investor protection, but also on varying degrees of agency enforcement zeal.

* The SEC has acted to safeguard the interests of investors since its creation in 1934. Similarly, the NASD, which supervises the activities of member brokers and dealers, has had rules of practice which safeguard investors since 1938.

** See Hackley, Our Baffling Banking System, 52 Virginia L. Rev. 565, 567 (1966). The liberal rulings of Comptroller of the Currency James T. Saxon exacerbated the disparities during the early 1960's, so much so that the Wall Street Journal stated that "there is something wrong with a regulatory system that not only keeps the regulators fighting among themselves but sets to shopping around for softer-hearted supervision", Wall Street Journal, Aug. 5, 1964 at 10, Col. 2.

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Conceivably, some investors could be provided with remedies to correct the effects of violations of the law in connection with their investments, while other investors may have no such remedies.* Since the market for financial services is a national market, the public would benefit if uniform standards, administered by an experienced regulatory body, were applicable to functionally identical activities.

Any expansion of banks' permitted activities in the securities field should be accompanied by measures which fully protect investors and customers of bank investment products and services. The banking laws are neither oriented toward, nor adequate for, this task. This fact was no better summarized than by Professor William Cary, then Chairman of the Securities and Exchange Commission, in Congressional testimony in 1963:

The great objectives of banking regulation are controls over the flow of credit in the monetary system, the maintenance of an effective banking structure, and the protection of depositors. These objectives neither utilize the same tools nor achieve the same ends as investor protection. The purpose of disclosure is to place the investor in a position to make an informed judgment on the merits of a security, and to provide a basis for comparing that security with others issued by companies in the same or different industries. Essentially this purpose is achieved

* This would depend, of course, on the final resolution of the status of private rights of action under the securities laws.

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through the furnishing of financial information which provides a uniform pattern of reporting. To say that bank regulation renders this disclosure philosophy unnecessary is to say that bank regulation is an effective substitute for the free exercise of an investor's judgment. Controls which protect against embezzlement and which assure adequate reserves serve important objectives, but not the objective of informed investment. To hold otherwise would be to imply that, because of such regulation bank securities are, without more, worthy investments *

Nor do the banking regulatory bodies possess the experience -- in the securities field or with the type of supervisory techniques -- necessary to insure that investors and customers of bank securities operations will be adequately protected. A recent General Accounting Office ("GAO") report on supervision of bank holding companies' non-banking activities by the Federal Reserve Board pointed out a number of shortcomings that are particularly troubling if banks are permitted to expand their securities activities.**

The GAO noted that bank inspections were too infrequent to protect against abuses and were targeted to ascertain bank

* Testimony of William Cary before the Senate Subcommittee of the Committee on Banking and Currency, SEC Legislation 1963: Hearings before a Subcommittee of the Committee of Banking and Currency, United States Senate, 88th Cong., 1st Sess., 20 (1963).

** Comptroller General of the United States, Report to the Congress: Federal Reserve Could Improve the Efficiency of Bank Holding Company Inspections (1981).

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solvency, not to protect investors.* Bank examiners were also found to lack expertise in non-traditional banking activities; thus, the quality of supervision of non-banking activities was uncertain.** The GAO also found that bank regulators relied heavily on on-site inspections and were unfamiliar with more effective monitoring procedures, including surveillance techniques.***

The potential effect of these deficiencies is illustrated by the case of the Sharptown State Bank in Texas. The Sharptown Bank was forced to close in 1971, following the revelation of a major stock fraud involving Frank W. Sharp, the bank's president.**** The scheme involved funnelling funds from the bank, through an affiliate and other conduits, to enable the affiliate to acquire stock in National Bankers Life Insurance Co. The assets of National Bankers Life were then channelled back to the bank to repay the loan. The purpose of the transaction was to inflate the price of National Bankers Life stock, which had been transferred to various Texas state legislators in exchange for their political support.

* Id. at 14.

** Id. at 16.

*** Id.

**** See "Collapse of Texas Financial Empire Shows Policing Problems; Political Impact Spreads," Wall Street Journal, Sept. 28, 1971.

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The scandal ultimately implicated the State Speaker of the House of Representatives, the Lieutenant Governor, a former state attorney general, and a former state insurance commissioner.

The scandal was discovered, not by the Federal Deposit Insurance Corporation ("FDIC"), but by the SEC, in connection with a routine examination of stock trading records at a Dallas securities firm. The FDIC, while uncovering practices of which it disapproved, failed to exercise its "cease and desist" powers to stop the practices that it had discovered. Reviewing the banking regulators' inaction, Rep. Wright Patman, then Chairman of the House Banking Committee, was prompted to conclude

[T]hese agencies are more interested in placating the banking industry than they are in protecting banks.*

* Id.

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THE NEED FOR A COMPREHENSIVE STUDY

The Investment Company Institute wholeheartedly concurs with Senator Garn's call to consider comprehensive legislation to restructure the financial industry. The Institute also agrees that developments in the financial services industry during the past decade may have required the modernization of existing laws and regulations.

However, before Congress realigns the statutory framework of the financial services industry, Congress should have available a comprehensive data base upon which to predicate its actions. The Investment Company Institute, for its part, would be pleased to supply Congress with information on the mutual fund industry, to contribute to this data base. Much of this information is already publicly available, since the mutual fund industry is subject to the rigorous disclosure regime of the federal securities laws.

In contrast, as a result of the discrete regulatory approach of the banking regulatory agencies, there is little information available from which to constitute the banking industry component of the necessary data base. From the information available, however, it appears that even in the narrowly circumscribed securities-related activities in which banks have been engaged since the enactment of the Glass-Steagall Act, banks have substantially disrupted

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normal banking operations and placed large sums of public savings at substantial risk without adequate safeguards or even public disclosure of such risks.

The current conduct of banks in securities-related activities is a highly relevant consideration if these activities are to be expanded. The following case histories discuss current bank securities activities, involving both bank trust department activities and other bank securities activities.

- Bank Trust Departments

Bank trust departments currently administer in excess of \$1/2 trillion in trust assets, either in individual trust and agency accounts or common trust funds and collective funds for retirement plans,* yet the role of banks in the trust field appears an accident. Moreover, the combination of commercial banking functions and trust functions inescapably presents serious conflicts of interest. As Austin Scott, the preeminent authority on trust law, has written:

It was perhaps something of an accident that the corporations which have obtained power to administer trusts are banking institutions. There is no necessary connection between the business of banking and the business of administering trusts.

* Federal Financial Institutions Examination Council, Trust Assets of Banks and Trust Companies - 1980, Table at 10 (1981).

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Indeed, many difficulties have arisen from the attempt to combine these two powers.*

-- Conflicts of Interest

Bank trust departments are often subject to pressures and conflicts of interest which arise from the bank's attempt to play the dual role of commercial lender and investment manager. Thus, because of its commercial lending activities, the bank may be subject to pressures to take action, such as buying or selling the stock of a commercial customer of the bank, for the purpose of bolstering the customer's creditworthiness, because of the importance of the commercial relationship between the bank and that company. In such cases, the bank can be tempted to make investment decisions on behalf of its trust accounts that are not in the best interests of trust beneficiaries.

An example is the conduct of the Denver U.S. National Bank, which sold the Denver Post stock held in its trust accounts to Helen Bonfils instead of to S. I. Newhouse, even though Newhouse was willing to pay a significantly higher price. As a House of Representatives banking committee staff describes the case:

* Scott, Fifty Years of Trusts, 50 Harvard L. Rev. 60, 62 (1936).

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Denver U.S. National had been involved with these trusts for many years and had strong ties with the Bonfils family. Therefore it would be natural for the bank to favor a sale to Miss Bonfils to preserve their present and possible future relationships rather than to sell this stock to the Newhouse publications, with which they had no relationship. This would also tend to sour relations between the bank and some of its customers.*

The sale to Bonfils rather than Newhouse resulted in a loss to the trusts of \$2.7 million, the amount of damages found by a court when held that the bank had breached its fiduciary duty.** Commenting on this case and the problem of trustee conflicts of interest, the House Banking and Currency Committee staff study concluded:

These cases illustrate quite well how a bank trustee with conflicting interests and pressures is either unwilling or unable to act strictly in the best interests of the beneficiaries.***

Bank trust departments also may be pressured by bank commercial customers to sell a customer's shares into friendly

* U.S., Congress, House Subcommittee on Domestic Finance, Committee on Banking and Currency: Staff Report, Commercial Banks and their Trust Activities: Emerging Influence on the American Economy, 90th Cong., 2d Sess., 1968, Vol. I, at 780.

** Described in D. Leinsdorf and D. Etra, Citibank, Ralph Nader's Study Group Report on First National City Bank, 249 (New York: 1973).

*** U.S., Congress, House, Subcommittee on Domestic Finance, Committee on Banking and Currency: Staff Report, Commercial Banks and their Trust Activities: Emerging Influence on the American Economy, 90th Cong. 2d Sess., 1968, Vol. I, at 785.

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hands on terms that may not be the most advantageous to trust beneficiaries. In one example, a major trust bank, which held approximately five percent of the stock of a good commercial customer in the bank's trust accounts, was faced with an attempt to take over the customer. The bank responded by purchasing more of the customer's stock for the bank's trust accounts, even though the stock was not on the trust department's approved purchase list.*

Bank trust departments may also be influenced in deciding whether to tender blocks of stock by the fact that there are other opportunities for profit. For example, the bidder may appoint the bank as the exchange offer agent in connection with an attempted acquisition.

In the SEC's discussion of National General Corporation's ("NGC") acquisition of Great American Holding Corporation ("GAHC") in the Institutional Investor Study, the SEC noted that although NGC had no previous commercial relationship with Girard Trust ("Girard"), Girard, which held five percent of GAHC's shares in its trust accounts, was named exchange offer agent for the acquisition.** Girard subsequently tendered

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** Institutional Investor Study Report of the Securities and Exchange Commission, House Doc. 92-64, 92d Cong., 1st Sess. (Vol. 5 at 2784) (Washington, D.C.: March 10, 1971).

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Another example is the effort of Electronic Data Systems ("EDS") to acquire Collins Radio Company ("Collins").* Two banks, Chase Manhattan Bank and Morgan Guaranty Trust Company, were both major creditors of Collins, and together held 23 percent of Collins' stock in discretionary trust accounts. The banks collaborated with Collins management to defeat a takeover by refusing to tender their shares and by changing the terms of their credit agreements with Collins to provide that outstanding loans were due immediately upon the acquisition of 30 percent of Collins' stock by a single owner. The beneficial owners of the Collins stock held by the bank trust accounts were thereby denied the acquisition premium which could have been obtained for their stock; the bank's relationship with the management of Collins was, however, preserved.

In virtually every bank trust department studied, it has been acknowledged that, at some time, the trust department's decision to sell securities of a good commercial customer "created a lot of flack."** The fear or reality of

* Herman, at 50-51.

** Id. at 53.

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unfavorable customer reaction reportedly has restrained trust department sales on numerous occasions, sometimes with foreseeably adverse effects on trust department clients.*

In one reported instance, in which a large new offering of a commercial customer's stock threatened to depress the stock's price, investment officers of the bank proposed selling the stock, buying warrants and waiting for a lower price. Top management decided, however, that as a matter of policy, the stock would not be sold. Some of the bank's investment officers reportedly thought that a material consideration in making this decision was the fact that the bank was an agent in the offering and would gain a substantial daily inflow of balances from it.**

In another example, where an officer of a bank was a director of a customer company and the bank performed a range of services for the customer, "the trust department was prevented from selling its holdings of the customer's stock because of the 'explaining' that the officer would have to do as a director of the company.***

* Id.

** Id. at 54.

*** Id.

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And, in another reported case, a commercial department, concerned over the effects of a potentially sharp drop in the price of a customer's stock on the customer's ability to pay back a large loan, pressured the trust department to delay a desired sale and to spread it out over a longer period.*

In yet another situation, the United Air Lines pilots' pension plan filed suit against Continental Illinois National Bank, alleging that Continental's trust department bought stock in Penn Central, Management Assistance Inc., Trans World Airlines, Lum's Inc. and United States Freight Co., without telling pension committee members that the bank had credit relationships with those companies.** The pension fund also accused Continental of seeking to improve its position as a creditor by buying the companies' stock for the pension funds in order to bolster the companies' finances. In 1981, Continental agreed to settle the case, paying nearly \$2 million to the trustees of the pension plan.***

-- Favoritism

Trust department abuses also arise because customers vary in importance to the bank and in sophistication, sensi-

* Id.

** "Continental Illinois Says it Settled Suit on Pilot Pension Fund," Wall Street Journal, March 10, 1981.

*** Id.

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tivity to performance, and willingness to apply pressure. If a bank trust department buys securities to accommodate its customers, the less desirable securities tend to be placed in the bank's less sensitive trust accounts.

It has been reported that "one bank trust department bought a large block of bonds of a corporate customer with which it shared an interlocking directorate, despite the fact that the stock of that company was not on the trust department's approved list."* The bond specialist at the bank reportedly stated that this purchase of bonds was expected of the bank as a quid pro quo for the board directorship, the appointment of the bank as collection agent on the bond issue, and generally good customer relationship.

A large number of these bonds were put into one of the bank's common trust funds and into a nonprofit trust account managed by the bank, two relatively weak and insensitive accounts.** An examination made of 14 trust portfolios held by this bank revealed that "special notes of the bank's own customers tended to show up regularly in the common trust funds and in nine of ten randomly selected portfolios of

* Herman, at 63.

** Id.

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small non-profit accounts but in only one of three portfolios of major companies.**

In the extreme case, these practices may result in loading the portfolios of the bank's less sensitive trust accounts with poor quality investments in order to improve the performance of the bank's more sensitive accounts. In one such instance, a customer which was highly dependent on credit from a powerful trust institution was virtually forced to place its pension fund with the bank. Approximately ten percent of the assets of this fund were thereafter placed in the stock of a second financially distressed customer with whom the bank was deeply involved and whose stock was of less than investment grade. Almost immediately after the acquisition, the price of this issue fell to a small fraction of its original price. Reportedly, a strong and alert pension fund customer of the bank had learned of the coming debacle and had insisted that the shares of the sagging company be removed from its portfolio. Because the market was thin, the shares were placed in weaker accounts.**

Customer accommodation through private placements is another area where the potential for abuse is great. For

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** Id.

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THE NEED FOR A COMPREHENSIVE STUDY

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In yet another situation, the United Air Lines pilots' pension plan filed suit against Continental Illinois National Bank, alleging that Continental's trust department bought stock in Penn Central, Management Assistance Inc., Trans World Airlines, Lum's Inc. and United States Freight Co., without telling pension committee members that the bank had credit relationships with those companies.** The pension fund also accused Continental of seeking to improve its position as a creditor by buying the companies' stock for the pension funds in order to bolster the companies' finances. In 1981, Continental agreed to settle the case, paying nearly \$2 million to the trustees of the pension plan.***

-- Favoritism

Trust department abuses also arise because customers vary in importance to the bank and in sophistication, sensi-

* Id.

** "Continental Illinois Says it Settled Suit on Pilot Pension Fund," Wall Street Journal, March 10, 1981.

*** Id.

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tivity to performance, and willingness to apply pressure. If a bank trust department buys securities to accommodate its customers, the less desirable securities tend to be placed in the bank's less sensitive trust accounts.

It has been reported that "one bank trust department bought a large block of bonds of a corporate customer with which it shared an interlocking directorate, despite the fact that the stock of that company was not on the trust department's approved list."* The bond specialist at the bank reportedly stated that this purchase of bonds was expected of the bank as a quid pro quo for the board directorship, the appointment of the bank as collection agent on the bond issue, and generally good customer relationship.

A large number of these bonds were put into one of the bank's common trust funds and into a nonprofit trust account managed by the bank, two relatively weak and insensitive accounts.** An examination made of 14 trust portfolios held by this bank revealed that "special notes of the bank's own customers tended to show up regularly in the common trust funds and in nine of ten randomly selected portfolios of

* Herman, at 63.

** Id.

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small non-profit accounts but in only one of three portfolios
 --- of major companies.**

In the extreme case, these practices may result in load-
 ing the portfolios of the bank's less sensitive trust accounts
 with poor quality investments in order to improve the per-
 formance of the bank's more sensitive accounts. In one such
 instance, a customer which was highly dependent on credit
 from a powerful trust institution was virtually forced to
 place its pension fund with the bank. Approximately ten
 percent of the assets of this fund were thereafter placed
 in the stock of a second financially distressed customer
 with whom the bank was deeply involved and whose stock was
 of less than investment grade. Almost immediately after the
 acquisition, the price of this issue fell to a small fraction
 of its original price. Reportedly, a strong and alert pension
 fund customer of the bank had learned of the coming debacle
 and had insisted that the shares of the sagging company be
 removed from its portfolio. Because the market was thin,
 the shares were placed in weaker accounts.**

Customer accommodation through private placements is
 another area where the potential for abuse is great. For

* Id.

** Id.

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example, the major New York City banks reportedly used cheap private placements to attract commercial business in the 1950's. Although private placements may be high quality investments, whether the extent of the private placement activity that occurred during this period was justified was apparently subject to considerable doubt.*

In one reported episode:

[B]ecause a major industrial company had several times changed the provisions of its private placement with two trust departments, the trust departments wanted to dispose of their holdings. The company did not want the bonds traded on any financial market because of a soon-to-be-issued affiliated credit company bond; so, not being able to buy its own bonds, it loaned a brokerage house the money necessary to acquire the bonds, pending relocation. The company then approached a large trust bank with which it had a director interlock and a major customer relationship and asked it to take some or all of the bonds. . . [T]he customer applied pressure on the commercial arm of the bank, including the threat of withdrawal of deposits and a shift of other business. . . [T]he bank's trust department, which had not been interested in private placements and ordinarily only bought bonds of a higher quality, was requested to take up part of the issue. After some resistance, the trust department agreed to do so, and it eventually absorbed half of this large private placement.**

-- Use of Confidential Information

The conduct of bank trust departments in connection with the failure of Penn Central also illustrates the abuses that

* Id. at 48.

** Herman at 50.

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frequently follow from banks' conflicts of interest in securities dealings. An investigation into the Penn Central failure revealed that large blocks of declining Penn Central stock were sold by bank trust departments immediately before the railroad's impending collapse became known to the public.

In particular, a 1972 study by the House Banking and Currency Committee Staff established that, during the months before Penn Central filed for bankruptcy, five institutions, including three bank trust departments, sold nearly 1.5 million shares of Penn Central stock. The amount of stock sold by these three bank trust departments alone consisted of more than 28 percent of the Penn Central stock during this period:

It becomes apparent that the trust departments of such banking institutions as Chase Manhattan conducted their massive sales of Penn Central stock on the basis of either great clairvoyance or inside information.*

The Committee staff noted that two banks, Morgan and Chase, which sold the most Penn Central stock during the two-and-one-half months, maintained several other relationships with the railroad. For example, Chase held about \$50

* U.S., Congress, House Committee on Banking and Currency: Staff Report: the Penn Central Failure and The Role of Financial Institutions, 92d Cong., 1st Sess., January 3, 1972, at 314.

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million of the railroad's outstanding debt, the railroad and its subsidiaries maintained deposits of about \$5 million with Chase, and the Chairman of the Board of Penn Central was a director of Chase Manhattan. Morgan Guaranty held about \$35 million of Penn Central debt and over \$6 million in deposits. In addition, directors of Penn Central were also directors of Morgan Guaranty. Considering the extent of these interlocks, the House Committee concluded that it would be impossible to dismiss the timing of the stock sales as mere coincidences.*

The SEC released its own study on the collapse of the Penn Central in August of 1972.** According to the SEC, officers from Morgan Guaranty's commercial department attended a meeting on the morning of May 28, 1970, where they learned "a good deal of information about the financial and operational condition of Penn Central which at that time had not been publicly disclosed.*** After the meeting, one of the officers described what they had learned in a confidential

* Id.

** SEC, Staff Study of the Financial Collapse of the Penn Central Company (1972).

*** Id. at 431.

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memorandum which had "normal distribution in the credit department."*

The next morning, May 29, 1970, three officials of Morgan Guaranty's trust department held a meeting which, according to one of them, lasted "two to three minutes at the most." Following this meeting, the three trust officers issued an order to sell all Penn Central shares from pension accounts managed by Morgan Guaranty. That day, Morgan Guaranty sold 45,930 shares of Penn Central, an amount equal to 21.6 percent of the total exchange volume for that stock that day.

* * *

These kinds of abuses have led numerous commentators to call for divestiture of banks' trust department activities.** Other experts have suggested that, in the absence of such a divestiture, the problem can only be alleviated by the full application of the federal securities laws.***

* Id. at 431.

** See, e.g., "Hunsicker, Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions," 50 Southern Cal. L. Rev. 611 (1977).

*** See, e.g., Garrett, "The SEC and its Concern with Bank Trust Activities," Trusts and Estates 280 (May, 1974).

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- Common Trust Funds and Collective
Funds for Retirement Plans

As serious as are the problems created by bank trust departments generally, they are far more severe when a bank trust department not only renders investment advice, but also originates and merchandises interests in a pooled investment fund to thousands of investors.

-- Common Trust Funds

National banks were first permitted to pool bona fide trust assets in common trust funds in 1937, in order to achieve diversification and administrative economies.* The Federal Reserve Board, and later the Comptroller of the Currency, have prohibited the merchandising and advertising of interests in bank common trust funds.** Congress exempted bank common trust funds from the federal securities laws and, instead, they are subject to the Comptroller's Regulation 9.***

The absence of regulation under the federal securities laws has created serious problems for investors in these funds. A current example is the ICU Fund.

* 2 Fed. Reg. 3440-41 (1937).

** 12 CFR §9.18 (1980).

*** 12 CFR Part 9.

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-- The ICU Fund

The ICU Government Securities Program ("ICU Fund") was established in 1968 as a common trust fund by its sponsors, the First Wisconsin National Bank of Milwaukee ("First Wisconsin") and the ICU Services Corporation ("ICU"), an affiliate of a credit union trade association.*

As of the beginning of 1977, the fund accounted for nearly 15 percent of all federal and state credit union assets available for investment.

The ICU Fund's reports to the SEC indicate that the Fund's operations have failed in material respects to conform to the representations which formed the basis for the Fund's exemption from the Investment Company Act. Indeed, certain of the Fund's activities would not have been permitted had the Fund been regulated under the federal securities laws, in particular the Investment Company Act.

Moreover, were the Fund subject to the Investment Company Act, the Securities and Exchange Commission could monitor the Fund's activities to guard against abuses. Instead of the SEC, however, the Comptroller of the Currency

* The SEC exempted the ICU Fund from regulation under the Investment Company Act, except for certain limited reporting requirements on the basis of representations made by the Fund sponsors as to how the Fund would operate. (Administrative Proceeding File No. 3-1445).

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The following account of the ICU Fund's present condition, which was carried in the October 12, 1981, edition of CUIS Newsletter, an independent newsletter for credit unions, indicates the consequences of the Fund's practices:

- CUS PULL FUNDS AS ICU RATES PLUMMET,
LIABILITIES EXCEED ASSETS

Account balances in ICU Services Corp.'s Government Securities Program (GSP) have declined from almost \$3 billion last year to \$736 million at the end of September. With the GSP's yield at 13.08 percent for September -- 300-400 basis points below comparable investments -- questions about its financial stability have arisen. In the unlikely event that all CUs asked for their money tomorrow, the GSP could not pay 100 cents on the dollar, according to ICU statistics. Nearly half the nation's CUs have funds in the GSP.

The GSP is "technically insolvent," says one analyst. Account balances at the end of August totaled \$758 million while the total market value of the GSP's assets (cash plus investments) totaled only \$708 million. For perspective, the same would be true of many S&Ls marked down their assets to market value as ICU does, noted observers. ICU reportedly has hundreds of millions of dollars in cash and equivalents to meet its obligations.

Even so, it's unclear where the GSP would get enough money to pay off all investors, in the unlikely event of a "run." Under ICU rules, any CU can demand -- and get -- its entire investment at any time, even if the fund has suffered losses in the interim. The same is not true of mutual funds, or even NIFCU\$, NAFCU's common trust fund.

* * * *

In sum, it has been reported that the ICU Fund is "technically insolvent" and its credit union investors' savings may have been endangered. The Fund's investment practices would not be permitted for SEC regulated investment companies.

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Of even more serious consequence, the Trust Agreement between ICU and First Wisconsin contained an arrangement whereby the Fund deferred both unrealized and realized market gains and losses on its portfolio from month to month. Under the Trust Agreement, no more than one-fifth of the net gain or loss in any one month may be added to or deducted from the ICU Fund's income. Although the SEC has permitted certain institutional money-market funds to value their assets on an amortized cost basis, rather than a "marking to market" basis, SEC registered funds have never been permitted to use an accounting method that requires automatic deferral of up to 80 percent of their unrealized gains and losses.*

The ICU Fund's 80 percent automatic deferral policy distorts the ICU Fund's rate of return and net asset value per share, and artificially insulates the Fund from the fluctuations which SEC registered funds are required to reflect and disclose. It also artificially insulates the ICU Fund from the effect of changes in the prime rate, thereby giving it greater flexibility in acquiring securities with longer maturities. The ICU Fund reports show that the Fund has utilized this advantage by investing its assets in treasury notes with long maturities.

* SEC Investment Company Act Release No. 9786 (June 7, 1977).

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* * * *

In sum, it has been reported that the ICU Fund is "technically insolvent" and its credit union investors' savings may have been endangered. The Fund's investment practices would not be permitted for SEC regulated investment companies.

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-- Bank Collective Funds for Retirement Plans

Prior to 1955, national banks placed assets of corporate retirement funds that they managed in their common trust funds. In that year, the Federal Reserve Board first authorized national banks to form new collective investment funds for the commingling of such assets.* Jurisdiction over these funds was transferred to the Comptroller of the Currency in 1962. The Comptroller's regulations, paralleling its regulations on common trust funds, prohibited merchandising and advertising.** Therefore, the SEC administratively took the position that interests in these pooled funds were exempt from registration under the Securities Act based on the "private offering" exemption.***

After some three years of hearings in both Houses, Congress enacted the Investment Company Act Amendments of 1970, which statutorily exempted bank collective investment funds for corporate retirement plans from SEC regulation.****

* 20 Fed. Reg. 3305 (1955); 12 CFR §206.10(c) [Cum. Supp. 1956].

** 28 Fed. Reg. 3312 (1963).

*** See SEC Memorandum re: Securities Act Rel. No. 4552 reprinted in Hearings on Common Trust Funds - Overlapping Responsibility and Conflict in Regulation Before a Subcommittee of the House Committee on Government Operations, 88th Cong., 1st Sess. (1963).

**** Pub. Law 91-547, 84 Stat. 1413.

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Shortly thereafter, however, in 1972, the Comptroller amended his regulations and permitted banks to advertise and publicize collective funds for retirement plans, thus vitiating the rationale for the exemption. That decision has contributed to the growth of a \$50 billion investment business which operates outside the investor protections of the federal securities laws; unfortunately, it has also led to serious conflicts of interest, a barrage of misleading advertising, and a lack of full and fair disclosure to investors.

--- Operation of the Funds

The Investment Company Act requires investment companies to establish and adhere to definite investment policies.* The Act also prohibits investment companies from changing their fundamental policies without shareholder approval.**

By contrast, bank managers of collective funds for retirement plans are not subject to any legal restrictions with respect to their freedom to change even the most fundamental aspect of their investment policies. A review of sample bank fund sales literature makes clear that bank fund managers take advantage of this regulatory vacuum by stating that the banks have complete freedom of action to make any

* Section 8(b), 15 U.S.C. §80a-8(b) (1976).

** Section 13(a), 15 U.S.C. §80a-13(a) (1976).

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type of investment, in any amount, for any reason whatsoever. Without approval or even notification to shareholders, the banks may change such fundamental investment policies as: the percentage of fund assets which may be invested in any one issuer; the percentage of outstanding voting securities of an issuer which may be purchased; the concentration of investments in a particular industry; or the decision to engage in such speculative activities as margin, short-sale and commodities transactions.

As a result, not only corporate employers, but also individuals who rely for their retirement security on an investment in a bank collective fund, have no influence or control over a fund's investment policies once their contributions are invested in the fund. Nor do they have assurances that, in the future, the fund will resemble the fund in which they originally invested, or that they will even know about a change in advance -- much less have an opportunity to withdraw their investments before any policy change is implemented.

The Investment Company Act also requires a registered mutual fund to credit investments and make redemptions on a daily basis.* This requirement in effect mandates daily

* Investment Company Act of 1940, 15 U.S.C. §22(c) (1976); 17 CFR §270.22c-1(1981).

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valuation of mutual fund assets. Banks are not required to value the assets of their funds on a frequent basis or, indeed, on any particular basis. Few, if any bank funds, therefore, value on a daily basis; many value monthly and quarterly.

Infrequent valuation dates allow the banks to deposit contributions in non-interest bearing accounts from the day of receipt until the next valuation date. Banks also may place withdrawals in one of their non-interest bearing accounts from a valuation date until the withdrawal check clears. Thus, the valuation procedures of the banks can create a significant amount of interest-free deposits which directly benefit the banks, at the cost of lost interest to investors.

Section 22(e) of the Investment Company Act requires registered mutual funds to make payment within seven calendar days of receipt of an order for redemption.* This requirement does not apply to the unregulated bank funds and, as a result, many of these funds make withdrawals or distributions only on a valuation date. The lack of any requirements in this area in effect permits a "float," where banks may leave uninvested cash in non-interest bearing accounts, to the benefit of the banks.

* Investment Company Act of 1940, 15 U.S.C. §80a-22(e) (1976).

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The frequency and magnitude of these conflict of interest deposits are staggering. The bank regulators' latest joint report showed that, as of December 31, 1980, \$3.08 billion of trust department assets were held in non-interest demand deposits in the trustee bank. Approximately \$650 million of that amount represented assets of employee benefit plans.*

Anti-self-dealing provisions of the Investment Company Act prohibit an investment company from purchasing securities from its investment adviser.** They also prohibit an investment company from loaning money to or purchasing securities issued by its adviser.*** The unregulated bank collective funds for retirement plans, however, are not inhibited by these proscriptions against self-dealing, and it appears that the frequency and magnitude of their conflicts of interest in this area are significant. The bank regulators joint report on trust assets showed that, as of December 31, 1980, \$6.4 billion of trust account assets were held in time deposits of the trustee banks.****

* Federal Financial Institutions Examination Council, Trust Assets of Banks and Trust Companies - 1980, Table at 10 (1981).

** Section 17(a)(1), 15 U.S.C. §80a-17(a)(1) (1976).

*** Section 17(a)(3), 15 U.S.C. §80a-17(a)(3) (1976).

**** Federal Financial Institutions Examination Council, Trust Assets of Banks and Trust Companies - 1980, Table at 10 (1981).

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Nearly \$2.25 billion of this amount represented employee benefit plan assets.*

--- Lack of Disclosure

An examination of the sales material of 17 banks relating to their pooled investment funds for Keogh plans reveals a startling lack of disclosure.

None of the 17 banks describes the fund's investment restrictions; none provides relevant information describing the policies of the bank in operating and advising the fund; none gives background information regarding the bank's officers and directors; none discloses the total fees paid to the bank in each of the last three years; none describes the fund's policy with respect to buying or selling portfolio securities; none discloses amounts of brokerage commissions paid by the fund or to whom; and over half do not contain the fund's current financial statements or the fund's current portfolio. In contrast, under the federal securities laws every mutual fund must provide all this information to all investors, including employee benefit plans.

* Id.

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--- Mass-Merchandising of Funds

The Comptroller's 1972 action opened the door to aggressive advertisement of the investment performance of their collective investment funds for retirement plans, and banks have done so with little restraint. A survey of recent bank advertisements promoting collective funds for retirement plans reveals numerous extravagant promises of extraordinary investment performance.*

For example, United Jersey Bank advertised in a June 1978 issue of the Newark Star-Ledger that "We're #1 nationally in investment performance." The bank proclaimed it was ranked "(F)irst in the nation for the year ending March 1978" in a Merrill-Lynch "survey of commingled equity funds." It went on to state that it has achieved "superior relative and absolute performance . . . consistently."

Hibernia National Bank also claimed to be "number one" in the April, 1978 issue of Institutional Investor Magazine. The bank advertised that it was the "#1 Bank Equity Fund Manager for the five years ended December 31, 1977, as measured by Frank Russell Co., Inc." Not to be outdone, First National Bank of Atlanta made a similar claim in the November,

* Attached at Appendix D are samples of the advertising employed by banks for their collective funds for retirement plans.

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1978 issue of Institutional Investor Magazine. The bank advertised that, "(f)or the past five years the First National Bank of Atlanta has consistently out-performed the other banks in the Frank Russell Survey." The First National Bank assured readers, however, that it accomplished this by "a consistently conservative investment posture."

Other banks have claimed that their performance made them "number one." For example:

- Marine Midland advertised in an April, 1978 issue of Pensions & Investments that it was ranked "first in 1-year performance" based on a survey by Pensions & Investments. It also claimed that it had "the highest rate of return on a 5 year basis for collective equity funds among the largest 25 U.S. bank trust departments," according to rankings in the federal bank regulatory publication "Trust Assets of Insured Commercial Banks."
- Fifth Third Bank of Cincinnati, Ohio, boasted in an April, 1978 issue of Pensions & Investments that "we do outperform the industry, year in and year out." The advertisement declared that the bank is "[e]ntering [our] second decade of outperforming Dow Jones."
- First Pennsylvania's October, 1978 advertisement asked The Wall Street Journal readers whether they would "like to learn more about First Pennsylvania's extraordinary record and how we can help you to achieve your performance objectives. . . ." The bank's advertisement claimed that the "First Pennsylvania is 'Most Consistent Manager' as seen in Pensions & Investments."

In many instances, the banks' claims can be justified, if at all, only because they very carefully selected the time periods used to measure their funds' performances. Thus,

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during 1977 and 1978, National City Bank of Cleveland claimed superior performance based on results during one, two, and three year periods. Marine Midland used one, three and five years; the First National Bank & Trust Company of Tulsa used seven years; Detroit Bank & Trust used an eight year period; First Pennsylvania Bank used one, three, five and nine year periods; and the National Bank of Detroit used a ten year period.

Not only have different banks carefully selected different time periods for purposes of advertising their performance records, they can change the period whenever necessary. For example, in the April, 1977 issue of Pensions & Investments, The First National Bank of Birmingham told readers about its "great investment record." Using the five year period from "1972-76 [as] a good example," the bank claimed that it "has been outperforming the industry standards for years." The following year, in an August, 1978 issue of Institutional Investor magazine, the bank advertised that it has "been topping the industry standards for years." This time, however, it selected the ten year period from 1968 to 1977 to describe its equity fund's performance.

In addition, banks have touted their investment performance by selecting the particular market index which best suited their claims. As noted above, Hibernia National Bank

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and the National Bank of Atlanta both claim to be the number one performer ranked by the Frank Russell Survey. The Fifth Third Bank of Cincinnati claimed it outperformed the Dow Jones Industrial Average. The National Bank of Detroit and the First National Bank & Trust Company of Tulsa compared their results with an A. G. Becker & Co. index. Marine Midland, First Pennsylvania, Security Trust and First National Bank of Kenosha based their performances on Pensions & Investments' Performance Evaluation Report. The First National Bank of Birmingham referred to Standard & Poor's index. United Jersey Bank used an index compiled by Merrill, Lynch, Pierce, Fenner & Smith.

Reviewing these examples, Senator Proxmire was moved to comment:

Its astonishing that they can do this and
the SEC has no authority, no jurisdiction . . .*

As the SEC then noted with respect to the advertisement of
advisory services:

In passing upon the propriety of securities selling techniques, we have repeatedly held that lax merchandising standards epitomized by such terms as "puffing" are antithetical to the anti-fraud provisions of the securities statutes. Similarly high standards of truthfulness and disclosure must also

* Hearings Before the Senate Committee on Banking, Housing & Urban Affairs on S.72, 95th Cong., 2d Sess., at 348 (1978).

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govern the propriety and legality of investment advisers' efforts to induce others to purchase their services. - They are particularly applicable to advertisements . . . which by their tenor show that they are designed to appeal to people who are anxious to secure quick profits and are not especially sophisticated in securities analysis. Many such persons are either unaware of or prone to overlook the limitations and uncertainties necessarily inherent in any attempt to forecast stock prices. They tend to be unduly influenced by advertisements representing or implying that the advertiser can make profitable forecasts and to subscribe to the advertiser's advisory service in reliance on them.*

Moreover, it has been held that advertising which "may be suitable for products which are subject to actual inspection and testing in use" are inappropriate in connection with the sale of securities, "which are goods of an intricate, complicated and intangible nature."** Apparently, based on the advertisements cited above, the banks have not yet learned that there is a difference between selling securities and selling a used car.

* Spear & Staff, Inc., 42 SEC 549, 553 (1965), CCH Fed. Sec. L. Rep. ¶77,216; Marketlines, Inc. v. SEC, 384 F.2d 264 (2d Cir. 1967); SEC v. C. R. Richmond & Co., 565 F.2d 1101 (9th Cir. 1977).

** Stanford Investment Management, Inc., 43 SEC 864, 867 (1968).

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- Other Bank Securities Activities

Since the enactment of the Glass-Steagall Act, banks have not only engaged in securities activities through their trust departments, but have also expanded into a myriad of other securities activities. These activities have been characterized by the same conflicts of interest, self-dealing, unsound practices and inadequate disclosures to investors that have characterized banks' other securities-related activities.

-- "Retail Repos" And "All-Savers" Certificates

A recent incarnation of the excesses of merchandising that has characterized bank collective investment funds for retirement plans has accompanied the banks' venture into retail repurchase agreements, or "retail repos," which are, in substance, uninsured debt securities issued by a bank. Retail repos are not insured deposits. However, they are exempt from the registration and disclosure provisions of the federal securities laws because they are the securities of a bank.* Banks and other depository institutions have recently sold over \$14 billion of dollars of such retail repurchase agreements.**

* Securities Act of 1933, §3(a)(2), 15 U.S.C. §77c (a)(2).

** Federal Reserve Rel. H. 6, Money Stock Measures and Liquid Assets, Oct. 9, 1981: "Small denomination (retail) RPS -- estimated at \$12.6 billion on a twelve month average basis and \$14.0 billion on a month-end basis in September" Table, Col. "M3," note 6.

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Retail repos have been promoted by means of advertisements which do not provide appropriate disclosure of the bank's financial condition, the nature and terms of the agreement (including minimum investment denominations, interest rates, maturities and any prepayment fees), and the nature of the security underlying the investment.* Retail repo merchandising implies that the investor is either making an insured deposit with the bank or obtaining an interest in a government security, not in a debt security issued by the bank. Customers are not advised that they may become unsecured creditors of shaky depository institutions, to the full extent that the market value of their security interest falls below the amount of the funds invested.

Despite the fact that the Comptroller of the Currency and the Federal Home Loan Bank Board have each interdicted retail repo advertisements that use words and phrases such as "guaranteed," "no risks," and "withdrawable accounts," or which imply that the investment is federally insured or guaranteed,** retail repo advertisements have often used these misleading terms. For example, recent advertisements

* Examples of retail repo advertisements are attached as Appendix E.

** See Comptroller of the Currency, Banking Circular No. 157 at 3 (May 13, 1981); Federal Home Loan Bank Board Memorandum No. R51a at 5-7 (Sept. 9, 1981).

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have used descriptive phrases such as "Guarantee," "Guaranteed," "Guaranteed Return" or "Guaranteed Interest." In reality, some of these offerings have been under-collateralized and substantial questions exist as to perfection of the security interest in the collateral under state law.

Similarly, although the banking authorities have warned that it is misleading to imply that a repo has any relationship to a money market fund, virtually all of the advertisements use the terms "Money Market Fund," "Money Fund" or "Fund." Moreover, several of the institutions have selected names that are similar to the names of money market mutual funds already registered with the SEC under the Investment Company Act of 1940.

This has naturally led to investor misapprehension, so much so that the Washington Post was misled into reporting that the Central National Bank of Silver Spring was operating a money market fund.* Furthermore, institutions which offer repos have ignored the regulators' demands that the absence of federal insurance be clearly shown in bold type.

Although there may have been an initial monitoring by the federal banking agencies, the repeated use of prohibited practices in advertisements shows its ineffectiveness. The

* A copy of this article is attached as Appendix F.

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aim of the monitoring -- to enable the public to distinguish between the characteristics of an insured certificate of deposit and an uninsured retail repo -- has not been successful.

Finally, while the bank regulators require the issuing institution to describe its agreement as one to repurchase for a "fixed amount," the offering materials and advertisements have often promised a return expressed in terms of interest rates, based on either daily or weekly computations.

The misinformation with which banks promote the instruments they offer has not been limited to repos. Aided by substantial tax concessions granted by the Congress, and a full-scale media campaign, depository institutions sold more than \$15 billion worth of All-Savers Certificates during just one week. As a recent Wall Street Journal article pointed out, however, "[w]hile the media blitz helped boost sales . . . many of the ads are filled with a jumble of tax information and misinformation."* For example, some certificates have been promoted on the basis of the higher 1981 tax rates, even though no certificate will mature until 1982. Many advertisements are contradictory: one bank states that a couple earning \$20,000 is in our 32% marginal tax bracket

* "Lull Before Next Rate Change On All-Savers Offers Chance to Compare Other Alternatives," Wall Street Journal, October 12, 1981, at 52.

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and would have to earn 17.85% on a taxable investment to equal the All-Savers yield; another institution claimed the same couple would be in the 20% bracket and would have to earn 16.18%

-- The New York City Debacle

The major exception provided in the Glass-Steagall Act permits banks to underwrite general obligation state and municipal bonds. The conduct of the major New York banks in regard to the New York City (the "City") financial crisis of 1975 demonstrates that even in the limited areas where banks are permitted to operate, banks' securities activities involve self-interested dealings which redound to the detriment of investors. While the underwriters of City debt securities included securities firms as well as banks, the principal underwriters were some of the nation's largest banks, including Chase Manhattan Bank, First National City Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Bankers Trust Company, and the Chemical Bank.

From October 1974 to April 1975, the City offered and sold through its underwriters about \$4 billion of short-term debt securities. In connection with the sale of these securities to the public, representations were made emphasizing the

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As the crisis worsened, the principal officers of the banks became actively involved in discussions concerning the City's fiscal crisis, the continued marketability of City securities, and the inadequacy of the disclosures being made to the investing public. Nonetheless, in early 1975, they proceeded, without adequate disclosure, with public offerings of over \$1.5 billion of City notes.

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A key role in the nationwide distribution of the City's securities was played by the City's principal underwriters: Chase Citibank, Morgan, Manufacturers Chemical Bankers and Merrill Lynch. The underwriters, through their own investments and by selling the City's securities to the investing public, enabled the City to raise billions of dollars in short-term debt issues through the Spring of 1975.

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Thus, beginning in the winter of 1974, City notes began to be marketed in denominations as small as \$10,000. This had the effect at least in part, of shifting the risk for financing the City from the City's major banks and large institutional investors to individual investors.

As the City's fiscal crisis worsened, the public was subjected to a confusing and contradictory financial picture with the result that the public, unlike the City and its underwriters, was deprived of a basic understanding of the City's finances. While the public was left largely uninformed, the City's underwriters had an increasing awareness of the range of problems underlying the City's fiscal crisis.

During 1974 and early 1975, certain of the underwriters of City securities ceased purchasing City securities for their fiduciary accounts. Despite the shift of investment policy, they continued as underwriters to market these securities to the public. The underwriters did not disclose this significant change in their investment strategy and policy.

The problems of the City came to a head in February and March 1975. A \$260 million TAN offering in February 1975 was cancelled when the City was unable to certify certain current information that the underwriters had requested from the City. At about the same time the City's major banks informed the Mayor and the Comptroller that the underwriters would be unable to continue to support the City by taking down City securities unless the City took immediate remedial action.

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and the National Bank of Atlanta both claim to be the number one performer ranked by the Frank Russell Survey. The Fifth Third Bank of Cincinnati claimed it outperformed the Dow Jones Industrial Average. The National Bank of Detroit and the First National Bank & Trust Company of Tulsa compared their results with an A. G. Becker & Co. index. Marine Midland, First Pennsylvania, Security Trust and First National Bank of Kenosha based their performances on Pensions & Investments' Performance Evaluation Report. The First National Bank of Birmingham referred to Standard & Poor's index. United Jersey Bank used an index compiled by Merrill, Lynch, Pierce, Fenner & Smith.

Reviewing these examples, Senator Proxmire was moved to comment:

Its astonishing that they can do this and
the SEC has no authority, no jurisdiction . . . *

As the SEC then noted with respect to the advertisement of advisory services:

In passing upon the propriety of securities selling techniques, we have repeatedly held that lax merchandising standards epitomized by such terms as "puffing" are antithetical to the anti-fraud provisions of the securities statutes. Similarly high standards of truthfulness and disclosure must also

* Hearings Before the Senate Committee on Banking, Housing & Urban Affairs on S.72, 95th Cong., 2d Sess., at 348 (1978).

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govern the propriety and legality of investment advisers' efforts to induce others to purchase their services. - They are particularly applicable to advertisements . . . which by their tenor show that they are designed to appeal to people who are anxious to secure quick profits and are not especially sophisticated in securities analysis. Many such persons are either unaware of or prone to overlook the limitations and uncertainties necessarily inherent in any attempt to forecast stock prices. They tend to be unduly influenced by advertisements representing or implying that the advertiser can make profitable forecasts and to subscribe to the advertiser's advisory service in reliance on them.*

Moreover, it has been held that advertising which "may be suitable for products which are subject to actual inspection and testing in use" are inappropriate in connection with the sale of securities, "which are goods of an intricate, complicated and intangible nature."** Apparently, based on the advertisements cited above, the banks have not yet learned that there is a difference between selling securities and selling a used car.

* Spear & Staff, Inc., 42 SEC 549, 553 (1965), CCH Fed. Sec. L. Rep. ¶77,216; Marketlines, Inc. v. SEC, 384 F.2d 264 (2d Cir. 1967); SEC v. C. R. Richmond & Co., 565 F.2d 1101 (9th Cir. 1977).

** Stanford Investment Management, Inc., 43 SEC 864, 867 (1968).

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- Other Bank Securities Activities

Since the enactment of the Glass-Steagall Act, banks have not only engaged in securities activities through their trust departments, but have also expanded into a myriad of other securities activities. These activities have been characterized by the same conflicts of interest, self-dealing, unsound practices and inadequate disclosures to investors that have characterized banks' other securities-related activities.

-- "Retail Repos" And "All-Savers" Certificates

A recent incarnation of the excesses of merchandising that has characterized bank collective investment funds for retirement plans has accompanied the banks' venture into retail repurchase agreements, or "retail repos," which are, in substance, uninsured debt securities issued by a bank. Retail repos are not insured deposits. However, they are exempt from the registration and disclosure provisions of the federal securities laws because they are the securities of a bank.* Banks and other depository institutions have recently sold over \$14 billion of dollars of such retail repurchase agreements.**

* Securities Act of 1933, §3(a)(2), 15 U.S.C. §77c (a)(2).

** Federal Reserve Rel. H. 6, Money Stock Measures and Liquid Assets, Oct. 9, 1981: "Small denomination (retail) RPS -- estimated at \$12.6 billion on a twelve month average basis and \$14.0 billion on a month-end basis in September" Table, Col. "M3," note 6.

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Retail repos have been promoted by means of advertisements which do not provide appropriate disclosure of the bank's financial condition, the nature and terms of the agreement (including minimum investment denominations, interest rates, maturities and any prepayment fees), and the nature of the security underlying the investment.* Retail repo merchandising implies that the investor is either making an insured deposit with the bank or obtaining an interest in a government security, not in a debt security issued by the bank. Customers are not advised that they may become unsecured creditors of shaky depository institutions, to the full extent that the market value of their security interest falls below the amount of the funds invested.

Despite the fact that the Comptroller of the Currency and the Federal Home Loan Bank Board have each interdicted retail repo advertisements that use words and phrases such as "guaranteed," "no risks," and "withdrawable accounts," or which imply that the investment is federally insured or guaranteed,** retail repo advertisements have often used these misleading terms. For example, recent advertisements

* Examples of retail repo advertisements are attached as Appendix E.

** See Comptroller of the Currency, Banking Circular No. 157 at 3 (May 13, 1981); Federal Home Loan Bank Board Memorandum No. R51a at 5-7 (Sept. 9, 1981).

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have used descriptive phrases such as "Guarantee," "Guaranteed," "Guaranteed Return" or "Guaranteed Interest." In reality, some of these offerings have been under-collateralized and substantial questions exist as to perfection of the security interest in the collateral under state law.

Similarly, although the banking authorities have warned that it is misleading to imply that a repo has any relationship to a money market fund, virtually all of the advertisements use the terms "Money Market Fund," "Money Fund" or "Fund." Moreover, several of the institutions have selected names that are similar to the names of money market mutual funds already registered with the SEC under the Investment Company Act of 1940.

This has naturally led to investor misapprehension, so much so that the Washington Post was misled into reporting that the Central National Bank of Silver Spring was operating a money market fund.* Furthermore, institutions which offer repos have ignored the regulators' demands that the absence of federal insurance be clearly shown in bold type.

Although there may have been an initial monitoring by the federal banking agencies, the repeated use of prohibited practices in advertisements shows its ineffectiveness. The

* A copy of this article is attached as Appendix F.

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aim of the monitoring -- to enable the public to distinguish between the characteristics of an insured certificate of deposit and an uninsured retail repo -- has not been successful.

Finally, while the bank regulators require the issuing institution to describe its agreement as one to repurchase for a "fixed amount," the offering materials and advertisements have often promised a return expressed in terms of interest rates, based on either daily or weekly computations.

The misinformation with which banks promote the instruments they offer has not been limited to repos. Aided by substantial tax concessions granted by the Congress, and a full-scale media campaign, depository institutions sold more than \$15 billion worth of All-Savers Certificates during just one week. As a recent Wall Street Journal article pointed out, however, "[w]hile the media blitz helped boost sales . . . many of the ads are filled with a jumble of tax information and misinformation."* For example, some certificates have been promoted on the basis of the higher 1981 tax rates, even though no certificate will mature until 1982. Many advertisements are contradictory: one bank states that a couple earning \$20,000 is in our 32% marginal tax bracket

* "Lull Before Next Rate Change On All-Savers Offers Chance to Compare Other Alternatives," Wall Street Journal, October 12, 1981, at 52.

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and would have to earn 17.85% on a taxable investment to equal the All-Savers yield; another institution claimed the same couple would be in the 20% bracket and would have to earn 16.18%

-- The New York City Debacle

The major exception provided in the Glass-Steagall Act permits banks to underwrite general obligation state and municipal bonds. The conduct of the major New York banks in regard to the New York City (the "City") financial crisis of 1975 demonstrates that even in the limited areas where banks are permitted to operate, banks' securities activities involve self-interested dealings which redound to the detriment of investors. While the underwriters of City debt securities included securities firms as well as banks, the principal underwriters were some of the nation's largest banks, including Chase Manhattan Bank, First National City Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Bankers Trust Company, and the Chemical Bank.

From October 1974 to April 1975, the City offered and sold through its underwriters about \$4 billion of short-term debt securities. In connection with the sale of these securities to the public, representations were made emphasizing the

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financial strength of the City and its capacity to meet both its principal and interest obligations on a timely basis. Throughout this period, however, the Banks had detailed knowledge of the impending financial crisis and the City's related problems: the growing gap between the City's revenues and expenditures; the use of short-term borrowings which had to be rolled over continuously to cover the gap; the widening of the gap during the 1974-1975 fiscal year; and the rapid growth of the City's short-term debt. The banks became increasingly aware during this period that the City would soon be unable to continue to finance its ever-increasing deficit.

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The City's securities offerings were carried out without adequate disclosure. As a result, the public's principal source of information, besides the stream of confusing and contradictory statements in the press, was the representations by the City and the underwriters attesting to the safety and security of City notes.

Indeed, as one of the underwriters' attorneys stated in April 1975 to the City's principal underwriters, "the adverse information which would be required in . . . [a disclosure document] . . . would in all likelihood render the City securities unsaleable."*

In addition, the SEC, as well as the New York State Office of Legislative Oversight and Analysis, concluded that the New York banks, and other major banks across the nation, "dumped" approximately \$2.3 billion in New York City securities on the market between the summer of 1974 and the final collapse of the market in March, 1975. Many of these sales were made without charging a commission -- an indication of the extent of the banks' desire to sell out quickly.

-- The REIT Experience

The record of bank involvement in real estate investment trusts ("REITs") is still another example of the conflicts of interest and abuses that arise when banks attempt to combine

* Securities and Exchange Commission, Staff Report on Transactions in Securities of the City of New York: Report on the Role of Underwriters 72-74 (1977).

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their commercial lending function with a securities-related enterprise. It is important to note that in many cases, the REITs were not managed by banks, but by bank affiliates.

REITs are investment vehicles that are strikingly similar to mutual funds. While REITs invest in real estate, often a majority of a REIT's portfolio will be invested in mortgages and securities, rather than in hard real estate assets. The function of a REIT, however, much like that of a mutual fund, is to provide investors of relatively modest means with professional management of a diversified investment portfolio. REITs also share similar organizational structures with mutual funds. Typically, REITs are organized, managed, and promoted by external management organizations. They seldom have more than a few employees of their own, and rely instead on the officers and employees of their external advisers to manage their business. Like advisers to mutual funds, REIT advisers have an incentives to increase the assets under their management through superior performance and the continuous sale of new securities, since an increase in assets results in increased profits for the adviser, who generally is paid a management fee based upon a percentage of assets. Thus, as assets under management grow, the adviser's fee increases.

Banking institutions were attracted to REITs in the late 1960's, when a number of large banks and their affiliates

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organized and promoted REITs. Banks and their affiliates were in a truly unique position to profit from REITs. Banks were not only able to realize normal profits from advisory fees, they were also, as a result of the bank's role as lender, able to gain additional profits. Once again, however, this combination of roles, each with its own set of conflicting responsibilities, proved disastrous. Bank profits frequently were derived from self-dealing transactions, and these transactions created many special hazards, not only for the REIT and its investors, but for the affiliated bank as well.

Conflicts of interest existed even with respect to bank-sponsored REITs' payment of advisory fees to their bank advisers. Since these fees were payable on the REIT's total assets, including borrowed funds and assets obtained by borrowing, banks had a strong incentive to leverage their assets highly. In addition, where a bank made loans to its affiliated REIT, the bank could substantially increase its profits through such transactions. Since the bank controlled the REIT, the bank could set the interest rate and other terms of the borrowing, thereby assuring itself an especially lucrative loan business. Moreover, unlike non-bank advisers to REITs or regulated advisers to mutual funds, bank sponsors of REITs were able to profit from the "float" generated by

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the transactions of their affiliated REITs. Developers might also be encouraged to use the bank as a depository for funds loaned by the REIT, and to enter into other banking relationships with the bank managing the REIT.

The bank/REIT relationship also gave a bank a significant incentive to maintain substantial cash balances in the REIT's checking account, and permitted the bank to channel loans from the REIT to developers on the basis of the profitability of the bank's own relationships with the developers. Banks could also use their affiliated REITs to avoid the existing regulatory restrictions on land and development loans made to their customers, and could sell loans from their own portfolios to their affiliated REITs when they needed to increase their liquidity or free up money for other purposes.

Bank-sponsored REITs frequently claimed that they enjoyed an advantage in that they had easier access to credit as a result of their affiliation with a bank. In fact, this "advantage" led to serious problems. Easy access to credit, coupled with the incentive for over-leveraging created by the advisory fee structure, contributed to REITs overcommitting themselves with respect to short-term borrowings that were highly sensitive to changes in interest rates. When interest rate changes swept the financial system in 1973, REITs discovered that the

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high costs of their short-term borrowings cut deeply into earnings and dividends. Lower earnings and dividends, in turn, began to affect REIT stock prices, credit ratings and ultimately their ability to raise funds.

As the problems of the industry grew, REITs increasingly turned to their banks for loans. At the end of 1972, the REIT industry had \$14 billion of total assets, only \$3 billion of which represented loans from banks. One year later, REIT industry assets had increased to \$20 billion and bank credit to \$6.5 billion. By the fall of 1975, total assets of the REIT industry amounted to approximately \$19.4 billion, with more than half, \$10.4 billion, in bank credit.*

By the end of 1975, REITs were even deeper in debt to their banks, and the quality of their loans had deteriorated substantially. One study found that approximately \$1.75 billion of the REIT loans it surveyed had been compromised by the banks, that is, the loans had been restructured to bear a lower interest rate than the contractual rate, payments were on an interest-only basis, or the loans were

* National Association of Real Estate Investment Trusts, REIT Fact Book 1976, 39 (1976).

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otherwise not producing full income.*

Thereafter, banks inexorably became publicly linked with the fortunes and misfortunes of their REITs. This development was accentuated by a number of factors, including the use of names that identified REITs with their bank sponsors, and the overlap of bank and REIT personnel. Because of the public identification of REITs and their bank sponsors, banks felt pressure to rescue their REITs. Banks were compelled to invest their own assets in REIT investments, provide their REIT affiliates with imprudent extensions of credit and subsidize REIT operations to an extent never envisioned.

Rescue efforts took a number of different forms; the primary technique used, however, was the loan swap. After a bank-sponsored REIT began to suffer cash flow shortages, the bank would purchase its troubled loans. Chase Manhattan Bank eventually acquired \$235 million in loans from its affiliated REIT, of which over \$130 million were non-earning. Chase also assumed an additional \$34 million of unfunded loan commitments to borrowers. Another rescue mission involving

* Statement of Kenneth D. Campbell, President, Audit Research, Inc., Real Estate Investment Trusts and the Effect They Have Had and May be Expected to Have on the Banking System: Hearings on S. 2721 Before the Senate Committee on Banking Housing, and Urban Affairs, 94th Cong., 2d Sess. 22, 23-24 (1976).

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swaps as well as straight cash payments took place in 1975 between First Wisconsin National Bank of Milwaukee and its troubled REIT. To settle claims brought by independent directors of the REIT alleging that the bank adviser had been negligent in placing certain loans, First Wisconsin agreed to purchase from its REIT participations in two mortgage loans valued at \$14.48 million.* It also agreed to reimburse the REIT up to \$5.5 million for losses on other loans.

There are many other examples of swaps between banks and their affiliated REITs. Continental Illinois Bank, for example, purchased at least \$61.2 million of loans from Continental Illinois Realty.** Continental's efforts to rescue its REIT also included swaps in which the REIT traded property with the bank and, in return, the bank cancelled debt that was earning only token interest. Continental had the pick of the best property, which it managed and later sold at a profit. Unfortunately, the REIT shareholders did not fare as well with their investments.***

* Keefe, Bruyette & Woods, Inc., Bank Loans to REITs: How Serious That Problem at 81 (May 2, 1975) [Special Section of the 1975 Bank Stock Manual].

** Id. at 69-70.

*** "Behind Homely Image of Continental Illinois Is An Aggressive Bank" Wall Street Journal, Oct. 15, 1981, at 1, col. 6.

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A number of banks became so deeply enmeshed in the problems of their REITs that the financial integrity of the bank itself was undermined, and a number of large banks were placed on the regulators' "problem list."** Even when the risks of real estate loans were assumed by an affiliate of the bank, rather than by the bank itself, there were serious implications for the banks in the holding company system. For example, in 1974, Beverly Hills Bank Corp., a one-bank holding company, got into trouble when a real estate developer defaulted on a loan. Immediately after publication of news accounts of the default, customers of the holding company's affiliated bank withdrew 15 percent of their deposits. As a result of this run on the bank, the Federal Reserve Board was forced to intervene, and the bank was ultimately sold to Wells Fargo, with a resulting loss of banking competition.**

* It was not unusual for banks to invest their own assets in affiliated REITs by maintaining compensating balances with other banks which made loans to their affiliates. *Id.* at 64-66. For example, the REIT affiliated with First Pennsylvania National Bank paid off \$12.5 million of a \$25 million loan from a foreign bank by a credit advance from First Pennsylvania. The foreign bank then allowed an extension on time to repay the remainder, conditioned on a \$7.5 million deposit from First Pennsylvania to add to its \$5 million already in an account with the foreign bank. Thus, in effect, First Pennsylvania had satisfied the \$25 million obligation of its REIT. *Id.*, at 66.

** House Comm. on Banking, Currency and Housing, 94th Cong., 2d Sess., Financial Institutions and the Nation's Economy, at 268 (Book 1) [compendium of papers prepared for the FINE Study] (Comm. Print 1976).

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Thus, the REIT experience, by duplicating the abuses of bank securities activities in the late 1920's and early 1930's, demonstrates the present-day relevance of the Glass-Steagall Act, and proves that

- The public will still invest a bank-sponsored investments in reliance on the reputation of the bank.
- In the event of problems with such investments, confidence in the sponsoring bank will be impaired because the public will associate the bank with the security.
- Banks will respond to pressures to misuse their credit facilities to bolster the fortunes of the investments they sponsor.
- Like other investors, banks will, on occasion, make unwise or imprudent investments; unlike other investors, however, when banks do so, the stability of sensitive financial institutions can be placed in jeopardy.
- Placement of bank securities activities in an affiliate provides an effective insulation, and cannot solve any of these problems.

-- Tender Offers

Serious conflicts of interest may also arise as a result of efforts by banks to play a multi-faceted role in connection with tender offers.

The recent battle for control of Conoco, Inc. among E.I. DuPont DeNemours & Co., the Seagram Company, Ltd., and Mobil Oil Corporation is a good illustration of the conflicts of interest that afflict banks in corporate takeovers. In the

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Conoco case, Bankers Trust of New York was listed as the single largest holder of stock in Conoco, with in excess of 5.6 million shares, and was also the largest shareholder of Mobil -- the very company whose acquisition overtures Conoco management was vigorously resisting -- with 13.3 million shares. Bankers Trust was also the twelfth largest investor in DuPont. Citicorp was ranked No. 2 with respect to Conoco, No. 4 with DuPont and No. 15 with Mobil. Chase Manhattan was No. 4 with Conoco, No. 5 with Mobil and No. 21 with DuPont.*

The position of Bankers Trust is of particular interest because Bankers Trust managed the employee stock plans at all three companies.** Thus, Bankers Trust would vote on behalf of the employee/shareholders on all sides of the Conoco takeover transaction.

A bank's relationships with its trust clients and its corporate customer which becomes the target of a takeover bid are often further complicated by the loan arrangements made with respect to the proposed acquisitions. As Rep. Berkley Bedell pointed out in a recent letter to the Federal Trade

* CDE Stock Ownership Directory: Energy (Corporate Data Exchange Inc., (1980)).

** Id.

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Commission in which he urged the FTC to investigate the role of institutional investors in the recent wave of major corporate mergers, in the case of some of the largest banks, the question is compounded by the fact that some of the same institutions are deeply involved in the financial arrangements attendant to the pending mergers.* These complications include the fact that banks often receive inside or market information in connection with making those financial arrangements, raising difficult issues with respect to the banks' obligations to investors in a bank trust account which holds shares of the affected companies.

Several other recent takeover bids further illustrate the extent to which banks' conflicts of interest may lead to abuses. For example, in 1976, Continental Illinois National Bank ("Continental"), solicited and obtained a portion of American Medicorp's ("Medicorp") banking business. A \$12.3 million loan was arranged by Continental and a second \$11.4 million loan was in process. In connection with this relationship, Continental also gave Medicorp advice on structuring a \$200 million capital expansion program. During the course

* Letter from Rep. Berkley Bedell to Hon. David A. Clanton, Chairman, Federal Trade Commission (July 21, 1981) reported in Wall Street Journal (July 24, 1981, at 23, col. 5).

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of a year's work, Continental had amassed files of non-public financial and other information concerning Medicorp, and had received a highly confidential five-year projection of earnings.

While Continental was in possession of this information, Humana, Inc. ("Humana") approached Continental's commercial loan department to obtain financing for its proposed tender offer for Medicorp's stock. Continental approved the loan application. Thereafter, the two Continental officers who worked on the Humana loan had access to Medicorp's credit file, consisting of more than 200 pages and including a detailed 13 page credit summary, and two loan officers working on the Humana loan and two working on the Medicorp account freely discussed the planned tender offer.

Medicorp brought an action to enjoin Continental from making a loan to Humana. The court held that Continental's loan to Humana was not a per se violation of trust, and that specific evidence that Continental had used confidential information obtained from Medicorp in deciding whether to make the loan to Humana would have to be presented.*

* American Medicorp, Inc. v. Continental Illinois National Bank and Trust Company of Chicago, 475 F. Supp. 5, 8 (N.D. Ill., 1977). "If [a bank] does not rely on the confidential information of its customers in its files, we believe that a bank is free to deal with any customer who comes to it." Id. (emphasis added).

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In yet another case involving questionable bank conduct in a takeover situation, Washington Steel had, since 1974, furnished Chemical Bank with ten-year cash flow and earnings projections and other non-public information in connection with a credit commitment with Chemical for up to \$2.25 million. Chemical also served as registrar for Washington Steel's common stock.

In January, 1979, Talley Industries, Inc., also a credit customer of Chemical, decided to acquire Washington. Representatives of Talley met with officers of Chemical and discussed the possibility of obtaining financing for the proposed acquisition. While both Talley and Chemical knew that Washington was a client of the bank, Chemical officers nevertheless decided that the bank's relations with Washington did not preclude it from participating in the financing of the proposed tender offer, and Chemical approved the loan.

Talley approached Washington Steel with an offer to merge, and when the offer was rejected, commenced a hostile tender offer to Washington Steel's shareholders. Washington Steel filed suit to enjoin the offer, alleging, among other things, that Chemical violated a fiduciary duty owed to Washington Steel by using confidential information obtained pursuant to the credit agreement in deciding whether to finance the tender

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offer. The district court issued a preliminary injunction against Chemical's financing the tender offer on the grounds that Chemical had breached a common law duty owed to Washington Steel arising upon receipt of Washington Steel's confidential information.

The district court's preliminary injunction was reversed by the Third Circuit, which held that neither Chemical's status as lender to Washington Steel nor its receipt of confidential information imposed upon it a per se fiduciary obligation to refrain from acting adversely to Washington Steel's interests. The court further concluded that the evidence failed to establish clearly that Chemical had used the information furnished by Washington in deciding to make the loan to Talley, and added that, in its view, the bank would have breached no duty to Washington Steel even if it had used the information.*

The decisions involving American Medicorp and Washington Steel indicate not only the potential abuses that may arise from conflicts of interest in bank involvement in takeovers, but also the present lack of standards available to prevent such abuses. To the extent that the potential for such

* Washington Steel Corp. v. T.W. Corp., 602 F.2d 594, 603 (3d Cir. 1979).

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abuses is increased by permitting banks to engage in more collective fund investment activity, a full consideration of the appropriate rules needed to govern such activities should be undertaken, and the necessary measures included in the legislation that is enacted. At a minimum, the Congress should resolve the long-standing and much-debated issue as to whether banks can satisfy their conflicting resolutions through the mechanism of a so-called "Chinese Wall," designed to minimize contact between a bank trust department, commercial loan department, and, if authorized, its mutual fund adviser.*

- Implications of Current Bank Conduct

These glimpses at the way banks currently conduct their securities-related activities, both through their trust departments and otherwise, demonstrate that the abuses that the Glass-Steagall Act sought to preclude can and do occur today with the same undesirable consequences for the banking system and the public. A comprehensive Congressional study may well lead to the conclusion that the restrictions contained in the Glass-Steagall Act should be strengthened,

* See Hunsicker, Conflicts of Interest Economic Distortions and the Separation of Trust and Commercial Banking Functions, 50 S. Cal. L. Rev. 611, at 634-647 (1977); Bruzda & Seidel, Bank Trust Departments and the 10b-5 Dilemma, 21 Vill. L. Rev. 367 (1976).

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not relaxed. At a minimum, we are confident that a comprehensive Congressional study will lead Congress to extend the federal securities laws to all bank securities activities.

The federal securities laws would provide investors in bank securities, clients of bank investment advisers, and customers of bank brokers or dealers with valuable prophylactic protections with respect to conflicts of interest. Further, these laws would assure disclosure of information meaningful to their investment decisions, and safeguards for their securities transactions.

However, today, the securities activities of banks are, with limited exception, exempt from regulation under the federal securities laws.* Bank securities are exempt from

* The limited instances in which banks are subject to the securities laws include the following: banks are subject to certain of the antifraud provisions of the securities laws, Section 17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §77q(a) (1976), and Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78j(b) (1976), which prohibit fraudulent or manipulative activities in connection with securities transactions; bank commingled funds for Keogh plans and Individual Retirement Accounts ("IRAs") are subject to registration and regulation under the Securities Act, 15 U.S.C. §77a et seq. (1976), and IRA commingled accounts are registered under the Investment Company Act of 1940 (the "Investment Company Act"), 15 U.S.C. §80a-1 et seq. (1976); banks are also included under the definition of "investment adviser" under the Investment Company Act, Section 2(a)(20), 15 U.S.C. §80a-2(a)(20) (1976), but only to the extent that they advise an investment company; banks are exempt from the requirements of the Investment Advisers Act, Section 2(a)(11), 15 U.S.C. §80b-2(a)(11) et seq. (1976) (the "Advisers Act").

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unknown at the time the securities laws were enacted. Moreover, these laws were not passed in a vacuum. The Securities Act and the Exchange Act are the second and third in a trio of laws passed in the wake of the stock market crash of 1929 and the subsequent collapse of the Nation's banking system. The first was the Glass-Steagall Act.

The securities laws' exemptions for banks reflect the strictly limited nature of the securities activities which were permitted to banks in the Glass-Steagall legislation. Banks were to purchase securities only upon the order and for the account of customers, strictly as an accommodation for existing customers. This service was to be provided upon the individual request of a bank customer and was to be performed at cost, without an element of profit for the bank, in keeping with its character as an accommodation. Under no circumstances was it contemplated that such limited, non-profit services would be vigorously advertised and otherwise promoted by a bank seeking securities business to enhance its profits.*

* This understanding is quite clear from the legislative history, including the following exchange, in which Thomas G. Corcoran, one of the principal draftsmen of the Exchange Act, explains the reason for the bank exemptions from that Act:

(footnote continued)

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Bank securities activities today bear little resemblance to those activities that led to the enactment of extensive statutory exemptions from the securities laws. Banks and their affiliates have developed dividend reinvestment plans, automatic investment services and portfolio management services. They sponsor closed-end investment companies and real estate investment trusts. Banks mass merchandise collective funds for retirement plans. They are seeking to commercialize their common trust funds. They provide advisory

(continued footnote)

MR. CORCORAN The bill needs to be clarified so that a bank which just acts for you in passing on an order to a broker, for you, does not come within that sort of a provision.

MR. KENNEY. Why should that limitation be taken out?

MR. CORCORAN. Because there are plenty of other limitations on the banks. A bank cannot normally go in the business, like a broker, of dealing in securities. For your convenience, for a service --

MR. KENNEY. But they do.

MR. CORCORAN. They are not allowed to do those things any longer, under the Glass-Steagall bill. They cannot go into a business of dealing in securities, but they can still make a service charge for passing on for you, as a customer --

Hearings on H.R. 7852 and H.R. 8720 Before House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 86 (1934) (emphasis added).

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services to millions of individuals and institutions, and have developed new investment media such as the so-called retail repurchase agreement. Banks have also begun to market the small denomination notes of bank holding companies, and have even sought to sell third-party commercial paper.

Large banks franchise their services to small banks and have permitted small banks to participate in their collective funds. All these activities -- some legal, many apparently not -- are occurring under the aegis of friendly regulators, and under the protectionist mantle of existing legislation that denies to the securities industry a comparable opportunity to compete in the commercial banking business.

Today, bank common trust funds have approximately \$30 billion in assets, bank collective funds for retirement plans have in excess of \$50 billion in assets, and banks provide advisory services in connection with \$1/2 trillion in assets.* Investors recently purchased \$14 billion in retail repurchase agreements, and \$13 billion in all-savers certificates. Literally millions of individual investors rely -- directly or indirectly -- on the integrity and expertise of banks and bank affiliates. Vast numbers of

* Federal Financial Institutions Examination Council, Trust Assets of Banks and Trust Companies 10 (1981).

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investors have been subjected to bank advertising which encourages them to put their money in a bank-sponsored fund or to retain the bank for individual investment advice. In light of this massive and targeted effort to market investment products and services to the public, the securities laws' exemptions for banks appear strikingly outdated. As SEC Chairman Harold Williams commented in 1979:

It would be anomalous if all financial institutions offering investment advice to the general public, whether directly or through publicly-solicited individual advisory relationships or indirectly through publicly-solicited collective investment management arrangements like investment companies, were not subject to the same regulatory requirements, the same fiduciary responsibilities and the same degree of enforcement presence.*

The banking laws are not an adequate replacement. For example, a national bank may exercise fiduciary powers only in compliance with Regulation 9.** But Regulation 9 utterly fails to provide the investor in bank common trust fund or collective fund for retirement plans with the independent checks on management, prohibitions on conflict of interest

* Statement of Harold M. Williams Before Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, Regarding H.R. 1539, H.R. 2747 and H.R. 2856, 96th Cong., 2d Sess. (1979).

** 12 C.F.R. Part 9 (1980).

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transactions with affiliates, shareholder or investor participation, disclosure of meaningful information, or other types of safeguards which are provided under the Investment Company Act.

Application of the Advisers Act to bank investment advisory services to individual clients would also provide investors with meaningful information, not now available, concerning the bank in its adviser capacity. Through SEC mandated disclosure, investors would be able to evaluate their bank adviser on the basis of the qualifications of the adviser and its personnel, the kinds of investment and analysis techniques used, and the basis for the fees charged. This information would be updated if it became inaccurate during the course of the advisory relationship. Bank advisers advertising would also be subject to standards with respect to the type of information included in promotional brochures and the way in which such information is conveyed.

Customers of bank brokers and dealers would also be benefitted if they were subject to rules regarding the suitability of securities recommended to their customers, protection of customers' securities and funds, personnel qualifications, record-keeping and audit requirements, advertising standards, and regulation of margin accounts, which protect the interests of customers of nonbank brokers and dealers.

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We have attached as Appendix F draft legislation which would properly regulate bank securities activities -- including common trust funds, collective investment funds for retirement plans, investment advisory activities, and bank securities such as retail repurchase agreements -- under the federal securities laws subject to the jurisdiction of the SEC. The Institute urges that these measures be given consideration in conjunction with the Committee's consideration of the pending proposed legislation, and subsequent proposals with respect to amendment of the Glass-Steagall Act. The improvement of the present regulation of current bank securities activities is a step that is long overdue, and must be a predicate for any expansion of banks' activities in this field.

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CONCLUSION

The Institute concurs with Senator Garn's observation that developments in the financial services industry during the past decade may have rendered existing laws and regulations obsolete and that it is now timely to consider comprehensive legislation to restructure the financial industry. However, S. 1720 and the Administration's recent proposal to permit banks to enter the mutual fund business will create serious problems for banks, the securities industry and, most importantly, the public.

Rather than precipitous action, what is needed is a comprehensive study based upon a complete data base. The Institute, for its part, would be happy to provide Congress with information on the mutual fund industry.

Because of the secrecy of the banking regulatory regime, there is little information available to form the banking industry component of the data base. From the information available, however, it appears that banks' securities-related activities, including bank-sponsored common trust funds, bank collective funds for retirement plans, bank-organized real-estate investment trusts, banks' new "retail repos" and bank involvement in corporate takeover contests already involve serious conflicts of interest, lack of investor safeguards and wholly inadequate disclosures.

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If any restructuring of the financial industry is undertaken, these current problems must be addressed. All bank securities activities, involving hundred of billions of dollars and millions of investors should be brought under the federal securities laws and the jurisdiction of the SEC.

Moreover, before any restructuring occurs to permit banks further into the securities business, the "level playing field" principle requires that securities firms be granted a reciprocal enhancement of powers to permit them to engage in the banking business.

The basic changes needed in the regulatory system which governs the nation's financial structure cannot safely be accomplished as the result of a few weeks' hearings. Rather, changes that will serve the Nation well in the long run must be carefully thought out, and can only be accomplished through the diligent efforts of all concerned segments of that industry and of its regulators.

This work should begin immediately. It will be a difficult task, but Congress and the Administration will have the full cooperation of the Institute in seeing it through.

APPENDIX A

CONCENTRATION OF FINANCIAL POWER

by Lance Gorton *

Introduction

In a modern industrial economy access to financial capital is crucial to individual corporations and equal access to financing for all corporations is an important concern of social policy. In the United States, access to financial capital in the amounts major corporations need is currently under the substantial control of a limited number of institutional investors.

In this paper, evidence on the concentration of shares of American corporations in the portfolios of institutional investors is surveyed. We show that institutions hold a large fraction of total stock outstanding, the different segments of the financial industry are each highly concentrated, and a small number of large banks, through their trust departments, are the largest holders of corporate stock.

We then examine various aspects of the relationship between institutional holders and portfolio companies. We find that the multiplicity of relationships between banks and portfolio companies is substantially greater than between other institutions and portfolio companies.

Since bank trust departments are among the largest holders of corporate stock and the number of relationships between banks and

*Professor of Economics, University of Utah. This paper is an extension of earlier work done with Donald Farrar and published jointly under the title "Institutional Investors and Concentration of Financial Power: Berle and Means Revisited," *The Journal of Finance*, May, 1981. Research support was provided by the Investment Company Institute and the Roland Stucki Fund for Research in Finance, University of Utah. John Schwalb provided research assistance.

portfolio companies is larger than for other institutional holders, we examine in greater detail the structure of the banking industry and the nature of the relationships between large banks themselves, between large banks and other large institutions, and between the large banks and some of the major industrial corporations in the United States economy. We find that the major banks are closely connected by holdings of each others' stock and by director interlocks in portfolio corporations. The extent and breadth of bank involvement in several companies in several major industries suggests that when a single company has a transaction with a major bank, it might be expected that the bank will be concerned with the impact of the transaction on the industry as a whole. The data presented here suggests that the financial system, with a few large banks at its center, may work to reduce competition and independent decision making in several major industries in the United States.

Paul Volcker, Chairman, Board of Governors of the Federal Reserve System, noted in a recent speech to the American Bankers Association that, "...the laws and traditions of this country embodying a separation of banking and commerce still seem to me fundamentally valid." "That tradition rests on concepts that concentration of economic power can be dangerous, that the potential for conflicts of interest in a service so vital as the extension of capital and credit should be minimized...." [15]

The evidence presented in this paper suggests that the potential for conflicts of interest in the banking system is substantial. The implications of concentrated financial power in the hands of a few financial institutions, especially the large banks, should be a concern of social policy, and should be taken into account when considering legislation permitting banks to expand their role in financial markets.

Institutional Holdings of Corporate Stock

In this section data is examined on the size and size distribution of institutional stockholdings, and on the extent to which institutional holdings are concentrated in the shares of particular companies.

A summary of holdings by major classes of institutional and other investors over the decade from 1969-78 is contained in Table 1. Institutional holdings of corporate stock amounted to approximately \$296 billion or 34.2 percent of all stock outstanding as of year-end 1969, of which bank trust departments held \$186 billion or 63 percent of the institutional total.¹

Over the nine years since 1969 institutional stockholdings have continued to grow until by year-end 1978 they amounted to more than \$450 billion, approximately 43.4 percent of the market value of all common and preferred stock outstanding. Growth, of course, has not been uniform across institutional types. Bank holdings have increased somewhat more rapidly than those of other major institutions; investment company stockholdings have declined over the decade, while holdings by life insurance companies increased at better than twice the average annual rate of growth of institutions as a group. Direct stockholdings by individuals remained more or less constant in absolute value over the decade, while their relative share of total outstandings declined.²

¹The definition used, like other definitions of total institutional stockholdings, is incomplete. (See notes 2-4 of Table 1.)

²Other indications of apparently continuing institutionalization of the stock market are reductions since 1970 in the number of individual direct shareholders and continuing reductions over the past two decades in the share of public transactions volume accounted for by individual direct investors. See [6], p.1; [7], 1979, p. 52; and [11], V. 8, p. 78.

Table 1
Market Value of Stockholdings
\$ Billions, end of year

	1949	50	51	52	53	54	55	56	57	58
Banks ^{1,5}	106.6	103.4	236.9	283.5	241.9	171.3	219.9	275.2	256.9	289.7(e)
Investment Companies	51.3	50.1	59.5	65.4	69.9	35.0	64.0	40.9	36.3	36.8
Life Insurance Companies	13.7	15.4	26.6	26.8	25.9	31.9	26.1	34.2	32.9	35.5
Property-Liability Insurance	13.3	12.2	16.6	31.0	19.7	12.0	14.2	16.9	17.1	19.4
Other, incl adj. ²	31.5	40.6	50.8	64.3	69.1	30.3	49.6	37.4	44.8	70.2
Total Institutions ^{3,5}	206.4	304.7	370.4	461.0	386.5	276.5	385.8	432.9	391.0	451.6(e)
Foreign	36.9	28.7	32.9	41.3	37.0	28.4	52.6	63.9	66.1	64.7
Individual and other ⁴	543.0	536.0	592.4	635.0	477.9	372.0	441.1	542.9	544.0	535.7
Total Stock Outstanding	846.3	859.4	1003.7	1136.1	901.4	641.7	849.5	1039.7	995.1	1041.0
Bank/Total Institutions	63.0	60.0	61.0	61.4	62.6	62.0	61.8	63.2	65.7	64.1
Bank/Total Stock Outstanding	31.5	31.6	31.0	34.9	36.8	36.7	35.9	35.6	35.8	37.8
Institutions/Total Stock Outstanding	34.2	28.5	37.7	40.6	42.9	43.1	41.9	40.5	39.3	43.4

Source: unless otherwise indicated, SEC Statistical Bulletin, July 1970.

¹ Includes common and preferred stock. Source: FISC Trust Assets of Insured Commercial Banks, 1969-77.

² Calculated as residual of total institutional and above commercial institutional types. Includes mutual savings banks and non-bank administered endowments, foundations and employee benefit plans. Also includes adjustments of various assets for inter-institutional holdings, such as holdings by other institutions of investment company shares.

³ As defined and tabulated by SEC in Statistical Bulletin, SE: 511-1, except that bank administered agency accounts, as reported in FISC Trust Assets of Insured Commercial Banks, SE: 511-1, are added thereto.

⁴ Calculated as residual of total stock outstanding and above commercial foreign and institutional investors. Will include certain institutional account types not covered by the above, such as stockholdings by director and personal agency accounts managed by investment advisers. The latter was estimated as exceeding \$20 billion in 1969. (SEC INSTITUTIONAL INVESTOR HOLDINGS, 1971, V. 1, p. 18.) No information is available regarding the former.

⁵ Estimated for 1970 by regressing Bank/Total Stock and Institutions/Total Stock, respectively, on a linear trend term, then applying the ratios so derived to SEC estimates of year-end 1970 Total Stock Outstanding.

Concerns over concentration of power require more than a showing that institutions as a group are substantial stockholders. Insight also is required into the distribution of such holdings within the various institutional sectors. Examining this question in 1969 the SEC's Institutional Investor Study [11] found that certain of the larger classes of institutional investors are rather highly concentrated. By 1969 the 10 largest bank trust departments administered 37 percent of all trust department assets, the 20 largest administered 51 percent and the 50 largest 70 percent ([11], V. 2, p. 477). To place these numbers in perspective, the 10 largest bank trust departments together held approximately \$68.7 billion in corporate stock as of year-end 1969, or about 8 percent of the market value of all stock outstanding at the time ([11], V. 2, p. 457; and Table 1 above).

Investment advisory firms are the second largest institutional holders of corporate shares. In addition to managing the funds of investment companies, for which such firms are well known, investment advisors also manage substantial pools of personal advisory accounts, employee benefit accounts and the funds of educational endowments, foundations and even certain insurance accounts. Mutual funds under investment advisor supervision held approximately \$51 billion in stock in 1969 and total accounts managed by such firms contained more than \$95 billion in stock at the end of that year ([11], V. 8, p. 18). Here too assets under management are relatively concentrated. The top 5 investment advisors managed 22.5 percent of all stockholdings held by the industry during 1969, the top 10 managed 36 percent, the top 25 nearly 60 percent and the top 50 almost 75 percent of all industry stockholdings ([11], V. 2, p. 158). It follows that the top 10 investment advisory firms managed approximately \$34.6

billion in common stock portfolios during 1969 or 4 percent of the market value of all stock outstanding ([11], V. 2, p. 158; and Table 1 above).

While total stockholdings by life insurance companies are smaller than for either banks or investment advisors, they are growing more rapidly and were far more concentrated in 1969 than was the case for any other institutional type. During that year the single largest life insurance company, Prudential, held more than 25 percent of all the stock-oriented, separate account assets in its industry. The top 3 life insurance companies held better than 50 percent of all such assets while the top 7 held more than 75 percent ([11], V. 2, p. 507). Together these firms held a little more than \$10 billion in corporate stock or approximately 1 percent of all stock outstanding. Should the 7 largest life insurers have retained their share of industry stockholdings through the past decade, those holdings now would exceed \$27 billion or 2.6 percent of all corporate stock outstanding ([11], V. 2, p. 507). Similar degrees of concentration apparently exist among other types of institutional investors as well ([11], V. 2, p. 848; and Table 1 above).

Given the size and apparent concentration of holdings by institutional investors, it becomes relevant also to examine the extent to which institutional portfolios may be concentrated in the shares of any subset of portfolio companies.

Wall Street folklore has held for some time that institutional stockholdings tend to be concentrated in the shares of relatively few, large "top tier" corporations. Until the early 1970's, however, this presumption does not appear to have been based on a very substantial body of factual data.

Several studies [10], [11], [16] which examined institutional holdings

during the 1960's indicated that, while institutional holdings were heavily invested in the shares of larger companies, they were not more concentrated in those shares than was the market as a whole. However, these studies were not well designed to assess the question addressed. Accordingly, Rosenberg [9] [11] as part of the Institutional Investor Study, reexamined the extent of concentration in institutional stock portfolios. His analysis was based on holdings of 800 common stocks by the 50 largest bank trust departments, 71 largest investment advisors, 26 largest life insurance companies, 25 largest property and casualty insurers and 41 largest self-administrated university endowments, foundations and employee benefit funds. The stock portfolios of institutions covered by his survey accounted for more than 70 percent of the stock held by all financial institutions on the survey date and for similarly large fractions of the stock held by each included institutional type.

The major thrust of Rosenberg's findings is that, for all types of institutions, holdings are concentrated in the shares of relatively few large companies to an extent greater than can be explained by the size of included companies relative to the market as a whole (p. 55). One measure of the extent of concentration within institutional portfolios is the fraction of total portfolio value invested in the single largest stockholding; another is the number of stocks required to account for half the market value of all stockholdings in the portfolio.³

Table 2 summarizes such values for the securities underlying Rosenberg's study. Here we see that the largest position in a typical large

³To be sure, financial institutions may hold large numbers of securities in their common stock portfolio. But, most of these holdings are relatively small and the great bulk of most such portfolios tends to be invested in the shares of relatively few large companies.

bank trust department accounts on average for 19.5 percent of the market value of the entire trust department's holdings of sample stocks and that only 8 stocks are required to account for half the market value of sample stocks held by the typical bank. Comparable figures for investment advisors are 13.8 percent of market value in the single largest holding and 9.6 stocks to account for half the market value of sample stock portfolio holdings.

Review of holdings by other institutional types reveals that such degrees of concentration are not unique to banks and investment advisors but appear to be characteristic of institutions in general.⁴ One also should note the considerable degree of commonality among stocks in which institutional portfolios are heavily invested. IBM, for example, appears among the 8 companies on average comprising the top half of sample stock-holdings by 48 of the 50 largest bank trust departments. General Motors is included in the top half for 42 of the 50 banks; Exxon is included in 34; Eastman Kodak in 39; etc. ([11] V. 3, pp. 134-47). The degree of commonality observed is striking, and they are the largest companies in the United States.

⁴To gain a sense of the extent to which these figures are affected by use of an 800 stock sample rather than an exhaustive set of all stocks in institutional portfolios, we may note that the largest holding by banks of sample stocks amounted on average to 11 percent of the bank's entire portfolio (vs. 19.5 percent of its portfolio of sample stocks), and for investment advisors 6 percent (vs. 13.8 percent). As the largest holdings in some cases will be in stocks outside the sample, fractions expressed as percent of entire portfolio ordinarily will be biased downward, just as fractions expressed as percent of sample stocks will tend to be biased upward when the largest holdings are in stocks which are part of the sample.

One should regard the very high degree of concentration in the portfolios of foundations and self-administrated employee benefit plans separately, since their funding is done under special circumstances.

Table 2
CONCENTRATION OF HOLDINGS IN INSTITUTIONAL
STOCK PORTFOLIO

Sample Stocks* Year End 1969					
Institution Type	Stock Holdings (1)	% Portf. in Largest Issues (2)	% of that Issue (3)	% Stocks in Top 500 (4)	% Stocks in Portfolio (5)
Bank Trust Departments	\$165	19.5	2.1	8.1	243.8
Investment Advisers	95	13.8	.9	9.6	96.4
Property & Liability Co's.	11	16.9	.6	8.4	47.7
Life Insurance Co's.	11	14.3	1.0	9.3	43.3
Self Admin. Employee Benefit	13	39.0	4.3	7.0	39.0
Self Admin. Foundations	12	43.7	3.0	2.6	27.7
Self Admin. Endowments	3	19.3	.2	6.7	35.0
All Institutions	311				
All Common Stocks (approx.)	1,000				

*Sample stocks consist of the following: 27 largest NYSE, 190 randomly selected NYSE (27 largest excluded), 100 randomly selected AMEX, 150 randomly selected OTC and 318 specifically selected for a variety of reasons. Total list = 793 securities.

(1) 0 Billions. Source: E18, V. 8, p. 18.

(2), (3), (4), (5) Source: E18, V. 3, pp. 1337, 1339, 1342-4.

Given the extent of concentration in institutional portfolios, relatively few institutions hold among themselves fairly sizeable fractions of the stock outstanding for a great many, large American companies. Specifically, 48 out of the 55 billion dollar (equity value) companies in the U.S. in 1969 had 5 or fewer institutional shareholders who, together, could aggregate 5 percent or more of the corporation's shares; two-thirds of such corporations had 5 or fewer shareholders who together could muster 10 percent of outstanding stock; and 16 percent had 5 or fewer holders of 20 percent of their shares ([11] V. 5, p. 2582).⁵

As all ten of the largest institutional holders of common stock are bank trust departments, these conclusions would not be effected to any important degree by substituting the word "bank" for "institution" in the paragraphs immediately above.

Multiple Business Relationships

In this section, we examine the extent and interdependence between different types of relationships between financial institutions and non-financial corporations. We find that the number of business relationships between banks and portfolio companies is much larger than between other financial institutions and portfolio companies. Also, we find we find that institutional holdings of portfolio company shares is related to other business relationships between financial institutions

⁵As portfolio companies became smaller these fractions decline, irregularly at first, then quite rapidly until as firms' equity values drop below \$250 million, one finds relatively infrequent incidence of concentrated institutional holdings. Among companies whose equity values were less than \$10 million in 1969, for example only one quarter had 5 institutional holders who could aggregate even 5 percent of the company's shares ([11] V. 5, p. 2582).

and corporations when the financial institution is a bank. The number of relationships between banks and portfolio companies and the apparent interdependence of the different relationships between banks and portfolio companies may put banks in a position to influence corporate decision making to a greater degree and more continuously than other financial institutions.

A comprehensive description of business and other relationships between 161 of the largest financial institutions and 288 sample companies was attempted by the Institutional Investor Study. The set of institutions, by now familiar, consists of 49 of the 50 largest banks, 69 of the 71 largest investment advisors, 21 large property and casualty insurance companies and 22 of the largest life insurance companies. The 288 company sample of non-financial corporations contained the 27 largest NYSE companies, 161 randomly selected NYSE, American Stock Exchange and over-the-counter companies, and a judgement sample of 107 companies.⁶

Data were collected on each of the business and personnel relationships considered and on company and institution size and geographic proximity for each of the 46,368 possible institution/company pairs.⁷ Business and personnel relationships are variables of interest; company and institution size and geographic proximity are used to control for what otherwise might be spurious sources of association between the business and other relationships.

⁶For a fuller description of the sample see [11], V. 5, p. 2720 and Supl. V. 11.

⁷161 institutions x 288 companies = 46,368 institution/company pairs.

Many of the observations, of course, are between institutions and companies which have no common business or personnel relationships. Indeed only 10,982, or about one-fourth, of the possible observations are between companies and institutions which "know" one another in at least one of the ways enumerated above. After eliminating null observations from the sample, the frequency of business and personnel relationships between sample institutions and companies which do "know" one another are as tabulated in Table 3.

Here we see that banks, in part because of their size and in part because of the broad range of their services, tend to have far more contacts with sample companies than do institutions of other types. The average bank summarized in Table 3, for example, had 196 separate business relationships with sample companies, of which 72 or a little over one third were duplicate or multiple relationships with a company known in at least one other way ([11], V. 5, pp. 2735, 2741). A typical investment advisor, by contrast, had only 43 contacts with the 288 sample companies, almost all of which were as a shareholder. Property and liability insurance companies averaged 36 such contacts; life insurance companies averaged 60, of which 27 were as stockholder and 23 were as creditor.

Analyses of the apparent independence (or interdependence) of business and personnel relationships between institutions and companies covered by the cross section of nearly 11,000 non-null institution/company pairs, are straight forward. Observations are grouped by institution type and, initially, simple pairwise correlations are calculated between: stockholdings, personnel, plan manager, creditor and other variables.

Table 3

NUMBER OF RELATIONSHIPS BETWEEN INSTITUTIONS AND 348 SAMPLE COMPANIES^a

	Shareholdings	Creditor	Depository	Employee Em. Plan Manager	Personnel
Banks (48)	5324	1581	2133	285	297
Investment Adv. (69)	2748	67	0	45	91
P & L Insurance (21)	640	43	0	0	69
Life Insurance (22)	598	506	0	96	113

^aSource, IIR, V. 3, pp. 2735, 2741.

Variables for the existence of personnel interlocks and employee benefit plan manager relationships are coded as dummy variables, = 1 if the relationship is present, = 0 if not. Regional proximity also is coded as a dummy variable, = 1 if company and institution are headquartered in the same Standard Metropolitan Statistical Area, or Standard Consolidated area if New York or Chicago, = 0 if not. Stockholdings, loans and demand deposits are measured as fractions of the company's outstandings of each. Company and institution size are measured in logarithms of market value of equity (for company) and market value of investment assets (for institutions).

All correlation coefficients between measures of business and other relationships are positive and highly significant if the institution in question is a bank (t-ratios typically are between 10 and 15); all are near zero if the institution is not a bank but an investment advisor, property and casualty or life insurance company (for which the largest t-ratio = 1.7) ([11], V. 5, p. 2742).

Multivariate regression analysis then is employed to sort out the impact on each variable of interest of all the others, and of control variables (company size, institution size and regional proximity), whose effects may be jointly pervasive and may account in part for the high pairwise correlations observed above (for banks). Results of these analyses are summarized in Table 4.

The pattern of intercorrelation between business and other relationships observed through simple, pairwise correlations remains in multivariate regression analyses if the institution in question is a bank, as does the converse if the institution is other than a bank.

Taking stockholdings as a fraction of the issuing corporation's outstanding as an example (Table 4, upper left hand panel), we see that the size of a bank's holdings of a company's outstanding stock is strongly and positively related to all of the existence or size of: personnel relationship, plan manager relationship and lending or deposit relationship, even after the effect of region, company and institution size are controlled for.

Institution size, of course, also is a highly significant variable. Large banks are likely to have larger holdings of portfolio company shares than are smaller banks.

As the typical bank in our sample holds on average only .0039 or .39 percent of the outstanding stock of a company from the sample which it "knows,"⁸ the existence of a joint personnel relationship would appear to be associated on average with a 172 percent increase in the fraction of stock outstanding held by the bank. The existence of a plan manager relationship increases the likely fraction of stock held by 146 percent.

Among non-bank institutions, only the three control variables, region, company size and institution size, exhibit positive, statistically significant, regression coefficients. t-ratios greater than 1.5 are exhibited by the relationship between stock outstanding and personnel interlocks for property and liability insurers and investment advisors; the estimated partial relationships for these variables both are negative, however, suggesting that large stockholdings by non-bank institutions are less likely rather than more likely when a common officer or director is present.

⁸ As sample banks "know" many of the sample companies only through commercial relationships rather than as stockholders, the average size of stockholdings when such exist will be greater than the unconditional average, .39 percent.

Dependent Variables
Insurers and Personnel Relationships by Institution Type

Dependent Variables: Stock/Outstanding										Dependent Variables: Loan/Outstanding									
Ranks		Z.S.s		Mile Ins.		Mile's		Ranks		Z.S.s		Mile Ins.		Mile's					
Coeff.	1	Coeff.	1	Coeff.	1	Coeff.	1	Coeff.	1	Coeff.	1	Coeff.	1	Coeff.	1				
Constant	-.0092	-	-.0012	-	-.0047	-	-.0030	-	Constant	-.0093	-	-.0116	-	-.0004	-				
Personnel	.0007	0.6	-.0017	1.9	-.0011	1.2	-.0034	2.6	Personnel	.0111	3.6	-.0091	3.6	-.0006	0.3				
Manager	.0007	0.6	-	-	-.0011	1.2	-.0015	0.9	Manager	.0020	0.6	-	-.0010	2.1	-.0008	0.3			
Loan/0	.0008	4.3	-.0041	0.5	.0003	0.1	-.0030	0.3	Stock/0	.0017	4.9	-.0124	0.6	-.0019	0.7				
Ins. Rep/0	.0025	2.6	-	-	-	-	-	-	Stock/0	.0106	1.7	-.0016	1.9	-.0019	0.3				
Region	.0023	3.1	.0009	1.1	.0012	1.4	-.0005	0.8	Region	.0046	0.1	.0006	1.9	-.0009	0.6				
Co. Size	.0001	1.2	-.0016	0.7	-.0005	2.4	-.0002	17.9	Co. Size	-.0011	10.0	-.0006	6.5	-.0001	9.0				
Inst. Size	.0023	11.7	.0010	3.0	-.0001	0.4	.0013	7.0	Inst. Size	.0005	6.9	-.0001	0.3	.0022	10.5				
R^2	.09	.11	.02	.12	.07	.04	.10	.001											

Dependent Variables: Personnel Title

Dependent Variables: Personnel Title																
Ranks		Z.S.s		Mile Ins.		Mile's		Ranks								
Coeff.	t	Coeff.	t	Coeff.	t	Coeff.	t	Coeff.	t							
Constant	-.1390	-.5027	-.6466	-.3423	-.7946	-.0000	-.0000	-.0000	-.0000							
Manager	.1240	10.1	-	-.0005	1.5	.0110	0.4	Personnel	.1272	10.1	-	-.0010	1.5	.0017	0.4	
Stock/0	2.1001	0.6	-3.1000	2.0	2.0075	1.9	-.0008	3.3	Stock/0	1.0116	7.6	-	-.0006	0.3	-.0008	0.9
Stock/0	.7992	2.7	.0008	0.6	-2.0093	2.0	.0030	2.4	Stock/0	.3205	0.0	-	-1.7074	1.7	.0270	0.1
Loan/0	.0015	0.6	-2.0053	2.4	-.0010	3.0	-.0031	0.3	Loan/0	.1010	6.0	-	-.0006	2.1	-.0207	0.3
Ins. Rep/0	.1219	5.1	-	-	-	-	-	-	Ins. Rep/0	.0700	2.9	-	-	-	-	-
Region	.0011	12.6	.0025	6.7	.0011	10.3	.0000	6.0	Region	.0003	10.6	-	-.0013	0.6	.0004	1.7
Co. Size	.0005	3.6	-.0035	5.0	.0009	0.3	-.0034	0.3	Co. Size	.0111	6.3	-	-.0012	0.9	-.0006	0.6
Inst. Size	.0011	0.3	.0024	1.3	.0106	3.1	.0031	1.2	Inst. Size	.0126	9.5	-	-.0013	5.1	.0004	3.3
R^2	.10	.11	.12	.02	.11	.03	.002									

Self observations are excluded from the above analysis. Numbers of non-zero observations for institutions/companies having at least one business or personnel relationship is given as follows: Banks, 4,070; Property and Liability Insurance companies, 301; Life Insurance companies, 1,101; Investment advisors, 1,040. Total sample, 10,182 institutions/companies pairs.

Stock/0, Loan/0 and Insured Depositor/0 all are measured as fractions of outstanding by the insurer. Stock/0 is defined as stock as a fraction of the institution's portfolio.

Source: 110, V. 5, pp. 2121-30, 2161-68.

Similar results are repeated for each of the other sets of analyses reported in Table 4. All of loans outstanding, personnel ties and plan manager are positively, and generally strongly, associated with other business relationships if the institution in question is a bank. All are weakly and/or negatively related if the institution is not a bank. For plan manager as dependant variable (Table 4, lower right hand panel), for example, we note that the probability that a bank will manage all or part of a company's employee benefit plan increases on average by statistically significant amounts with increases in all of stockholdings, loans and deposits, but that the strongest relationship (other than regional proximity) is with "personnel." Should company and bank have an officer/director in common, the probability that the bank will manage at least some portion of the company's employee benefit plan increases by 12.7 percent. This nearly quadruples the 4.77 percent unconditional probability that a sample bank will have a plan manager relationship with one of the sample companies ([11] V. 5, p. 2741).

Relationships Between Large Banks

In the previous sections, the large banks stand out from other financial institutions by virtue both of the size of their stockholdings and the number of interactions they have with the portfolio companies. Since the large banks appear to be of special importance, in this section some aspects of the relationship between the large banks are investigated. We look at stockholdings of large banks in other large banks, holdings of bank stock by large non-bank institutions, and the extent of indirect director interlocks between major banks. In addition to the high degree of concentration of equity holdings in a small number

of large banks, the major banks are closely connected by holdings of each others' stock and by director interlocks in portfolio corporations.

Data used here on stock holdings of bank stock and on director interlocks between major banks is from Structure of Corporate Concentration, [14] (referred to a Concentration Study), a 1980 study done for the Committee on Governmental Affairs, United States Senate. The Concentration Study used data for the first quarter of 1980.

Table 5 contains information on the six largest New York banks. The Table covers the holding of stock issued by each of the six banks and held in the other five banks, the number of indirect director interlocks between the banks in the sample of 100 of the largest corporations in the United States, and the percent of stock held by the 5 largest institutional holders of each banks stock. The left-hand column in Table 5 contains the bank issuing the stock and the rank of the bank by size. For example, the top position among New York banks was held by Citicorp, the second largest bank in the United States. Across the top of the table are the same six banks as holders of the stocks. The numbers in the body of the table show, in order, the rank of the holding bank among all institutional holders of the issuing banks' stock, the percentage of total stock issued held by the bank, and the number of indirect director interlocks between the issuing bank and the holding bank. An indirect director interlock occurs when a director of the issuing bank sits with the director of the holding bank on the board of directors of a third corporation included in the Concentration Study sample of 100 large corporations. For example, looking at the three numbers in the Chase Manhattan row and the Citicorp column, we find that Citicorp was the number one institutional holder of Chase stock, that Citicorp

holdings represented 2.13% of the total of Chase stock outstanding, and that Chase and Citicorp interlocked 33 times on the boards of the other 98 companies in the sample.

Summary statistics are presented in the three right-hand columns and in the bottom row of the table. For example, 5.60% of Citicorp stock was held in the trust departments of the other 5 New York banks, and Citicorp interlocked with the other banks a total of 142 times on the boards of the 94 corporations left in the sample after eliminating the 6 New York banks, for an average of over 28 interlocks with each of the other 5 New York banks. As indicated at the bottom of the column, the six banks interlocked 333 times on the boards of the 94 largest corporations in the United States. The percent of stock held in the 5 banks, other than the issuing bank, ranged from 2.71% of Chemical Bank stock held to 7.86% of Manufacturers Hanover stock. Taking the simple average of the percentages held, the typical large New York bank had 5.18% of its stock held in the trust departments of the five other large New York banks. The bottom row in the table shows the average position of each bank in the other 5 banks. For example, Citicorp held on the average 2.17% of the stock issued by each of the other banks. The average holding of each of the banks in each of the other 5 banks was approximately 1%. The far right-hand column shows the percent of the stock issued by each bank held by the 5 largest institutional holders. The average New York bank included in the table had over 10% of its stock held by the 5 largest institutional holders of its' stock.

The Concentration Study data also shows that of the 100 large corporations surveyed 19 had over 500 direct and indirect directory

TABLE: 5
Stockholdings Among 6 Largest New York Banks - First Quarter 1980

HOLDER

	CC	CH	MH	JPH	CYN	BT	% Common Stock Managed By Other 5 NY Banks	Total/Avg. Number of Interlocking Directorships	% Stock Held by 5 Largest Holders
Citicorp (2) (D)	(A) 59 (B) .23 (C) -	8 1.24 33	20 .60 26	1 2.78 35	99 .11 27	12 .87 21		142 28.4	10.98
Chase Manhattan (3) CH	1 2.13 33	24 .50 -	4 1.19 22	36 .36 19	104 .03 17	14 .67 15		106 21.2	7.51
Manufacturers Hanover (4) MH	4 2.31 26	7 1.83 22	12 1.05 -	3 2.63 23	101 .04 22	13 1.05 13		106 21.2	12.74
J.P. Morgan (5) JPH	7 1.44 35	4 2.39 19	15 .91 23	22 .70 -	39 .37 25	17 .84 9		111 22.2	13.41
Chemical New York (6) CNY	5 1.13 27	49 .07 17	26 .36 22	12 .80 25	14 .72 -	27 .35 26		117 23.4	7.30
Banker's Trust New York (9) BT	1 3.84 21	37 .09 15	24 .21 13	14 .41 9	- - 26	44 .06 -		84 16.8	9.82
Average %	2.17	1.12	.65	1.40	.11	.76	5.18 1.04	333 22.2	10.29

Source: Structure of Corporate Concentration, pp. 118-120, 666-733.

Note:

A) Rank among holders of the issuers stock

D) Rank of bank by size

E) Average of the 5 other banks held

in the portfolio

B) Percentage of outstanding stock held

C) Number of interlocking directorships

interlocks with other corporations in the sample. Of the 19 corporations with over 500 interlocks, 5 were large New York banks. The remaining bank, Banker's Trust, fell short by 8 with 492 interlocks.

Table 6 presents similar data in the same format for the 10 largest banking corporations in the United States. The same sort of pattern emerges. Bankamerica was the number one institutional holder of Western Bancorp and Morgan was the number one institutional holder of Bankamerica stock. 6.51% of Bankamerica stock and 7.98% of Western Bancorp stock was held in the other large banks.

In addition to the substantial holdings by large banks of stock issued by other large banks, the Concentration Study reveals that a few non-bank institutions held substantial positions in several of the largest banks. Information on these holdings is presented in Table 7. At least six non-bank corporations held substantial positions in several of the largest banks. Prudential Insurance was the number 2 institutional holder in Citicorp, the number 2 holder in Continental Illinois, the number 3 institutional holder in Western Bancorp, and the number 5 holder in Bankamerica. Continental Corp. was among the top 24 institutional holders in 8 of the ten largest banks, including the number 2 position in Manufacturers Hanover and number 6 position in Morgan. The last row of Table 7 gives the percent of each of the ten banks held by the 6 non-bank institutions covered. The six non-bank holders together held more than 4% of the stock outstanding in 7 of the largest 10 banks.

It is notable that SEC data reveals that the largest institutional holders of Continental Corp. stock are (see Table 8) Manufacturers Hanover, number 1 with over 3.5% of the total, Western Bancorp number 3, and Morgan, number 8 with 1.42% of the stock outstanding.

TABLE 6
Stockholdings Among 10 Large U.S. Banks - First Quarter 1980

HOLDER

	BOA	CC	CH	HH	JPM	NY	CT	VB	BT	FCC	% of stock held by other 9 banks	# of interlocking directors w/ 9 banks
BankAmerica	(A) 9	4	24	7	1	111	25	22	23	8		
BOA	(B) .87	1.28	.40	1.02	1.65	.44	.38	.45	.41	.88	6.51	80
Citicorp	(C) -	20	4	4	44	.04	2	13	5	10		
Chase	201	59	8	28	1	99	50	65	12	98		
CC	.02	.23	1.24	.40	2.78	.11	.26	.22	.87	.11	6.21	194
Chase	20	-	32	26	35	27	12	12	21	8		
Manhattan	.77	1	24	4	36	104	39	82	14	66		
Manhattan	.07	2.13	.58	1.19	.36	.03	.33	.06	.67	.11	4.95	128
CH	4	33	-	22	19	17	7	3	15	.8		
Manufacturers	-	4	7	12	3	101	73	57	13	-		
Manover	-	2.31	1.83	1.05	2.63	.04	.08	.14	1.05	-	8.10	129
HH	4	32	22	-	23	22	4	4	13	4		
J.P. Morgan	5	7	4	15	22	39	19	88	17	21		
Corp	1.62	1.44	2.39	.91	.70	.37	.73	.13	.84	.70	9.13	131
JPM	11	35	19	23	-	25	3	2	9	4		
Chemical	-	5	49	26	12	14	-	62	27	-		
New York	-	1.13	.07	.36	.40	.72	-	.03	.35	-	2.74	139
NY	3	27	17	23	25	-	10	2	26	7		
Continental	106	3	35	3	10	90	7	41	52	4		
Illinois	.03	2.72	.44	2.51	1.73	.05	2.06	.35	.26	2.60	10.69	87
CI	2	12	7	4	3	10	-	3	10	36		
Western	1	75	9	21	10	106	80	8	56	32		
Bancorp	3.56	.09	1.50	.68	1.49	.02	.07	1.79	.18	.39	7.98	45
VB	12	12	3	4	2	2	3	-	3	3		
Banker's Trust	-	1	37	24	14	-	-	56	44	-		
New York	-	3.84	.09	.21	.41	-	-	.02	.06	-	4.61	108
BT	5	21	15	13	9	26	10	3	-	6		
First Chicago	106	21	5	35	9	50	31	64	27	1		
Corp	.03	.55	1.81	.30	1.47	.13	.39	.08	.43	7.26		
FCC	10	8	8	4	4	7	36	3	6	-	5.19	86

Sources: Structure of Corporate Concentration, pp. 118-120, 666-753.

Note:
A) Bank among holders of the issuer's stock
B) Percentage of outstanding stock held
C) Number of interlocking directorships

Institutional Holders of Large Bank Stocks - First Quarter 1980

Issuer	BOA	CC	CH	MB	JPM	CHY	CI	WB	BT	FCC
<i>HELPER</i>										
(A)	3	-	3	16	-	2	-	-	-	2
(B)	1.35	-	1.23	.86	-	1.60	-	-	-	2.34
(C)	-	-	-	-	-	-	-	-	-	-
Teledyne										
Prudential Corp	5	2	78	79	-	40	2	3	42	59
	1.05	2.38	.07	.07	-	.10	2.84	2.49	.07	.10
	-	13	9	5	5	6	2	1	8	2
Continental Corp	48	7	9	2	6	11	24	49	6	13
	.17	1.41	.88	2.71	1.50	.83	.90	.24	.88	.93
Cal. Public Employees Retirement	2	10	5	-	-	-	-	-	-	-
	1.52	1.07	1.19	-	-	-	-	-	-	-
TIAA CREF	12	5	7	5	-	-	21	-	-	8
	.85	1.86	.94	2.01	-	-	.97	-	-	1.63
Price T Rowe Assoc.	-	4	-	-	2	-	-	-	-	-
	-	1.90	-	-	3.18	-	-	-	-	-
	-	-	-	-	-	-	-	-	-	-
Σ % Above	4.94	8.62	4.31	5.65	4.68	2.53	4.71	2.73	.95	5.00
										4.412

= 1 + 10

Source: Structure of Corporate Concentration, pp. 118-120, 666-753.

Note:

A) Rank among holders of the issuer's stock

B) Percentage of outstanding stock held

C) Number of interlocking directorships

Table: 8

Institutional Holdings of Stock
of Continental Corp.
(Total Outstanding: 53,510,000)

	# of Shares Held	% of Outstanding	Σ % Out.
1 Manufacturers Hanover	1,944,455	3.63%	3.63%
2 Delaware Mgt. Corp.	1,543,797	2.89%	6.52%
3 Western Bancorp	1,067,040	1.99%	8.51%
4 Continental Corp.	1,063,325	1.99%	10.50%
5 First Union Bank Corp.	956,025	1.79%	12.29%
6 University of California	938,358	1.75%	14.04%
7 Girard Co.	789,939	1.48%	15.52%
8 J.P. Morgan Corp.	758,000	1.42%	16.94%

Source: Spectrum 3: 13(F) Institutional Stockholdings Survey; Computer
Directions Advisors (3-31-79), pp. 338-340.

The analysis of stock ownership patterns and interlocking directorate relationships among the 6 largest New York banks and the largest 10 banks in the country indicates that these financial institutions are interrelated to an degree that casts doubt on the wisdom of treating them as totally independent institutions. Banking in the United States would seem to be even more concentrated functionally than standard concentrations measures would suggest.

Concentration of Bank Holdings in Individual Industries

Recent data shows that one or a small number of banks and other institutions have substantial holdings across companies in several different major industries. Here we give only a brief recitation of some of the more prominent situations brought out in the Concentration Study of 100 companies. In our view, questions of the existence and importance of holdings of stocks by a single bank or interrelated group of financial institutions merit much more attention than has been received.

Some of the results of the Concentration Study are highly suggestive. J. P. Morgan was the largest institutional holder of Pan American and Eastern Airlines stock, the number two institutional holder of United Airlines, and the number three holder of American Airlines. In retailing, J. P. Morgan was the largest institutional holder of K Mart, J. C. Penney, and Mobil (Montgomery Wards); second largest of Sears Roebuck, (Sears was the largest holder of its own stock); and the third largest holder of Federated Department Stores. In the chemical industry, Manufacturers Hanover was the fourth largest institutional holder of Union Carbide and the fifth largest holder of Du Pont, Dow, and Monsanto.

In energy companies, Chase Manhattan was the largest institutional holder of Exxon, second in Standard of Cal., third in Standard of Indiana, and fourth in Mobil. In information processing and office equipment, J. P. Morgan was the largest institutional holder of IBM, RCA, Sperry, and Xerox; and the fourth largest institutional holder of Eastman Kodak and Honeywell.

The examples in the preceeding paragraph are not meant to be exhaustive, since the Concentration Study from which the examples are drawn included only one hundred corporations, but only suggestive of the type of pattern that might emerge from a more detailed analysis of SEC data on institutional stock-holdings by industries.

Role of Banks

Banks have been distinguished from other financial institutions by the size of their equity holdings and the multiplicity of the relationships between banks and corporate customers. Evidence has been presented that indicates that the large banks are interconnected to a degree that raises doubt about whether decision making is independent. Also, in some industries a single bank holds substantial positions in several "competing" corporations within an industry. What then does this evidence suggest is the role or function of the large banks in the financing of major American corporations?

The size of institutional stockholdings in general and of holdings by banks in particular have led to the suggestion that financial institutions control major corporations in America. For example, Adolph Berle in an interview for Dunn's Review a decade ago stated:

"In recent years, stock has become more and more concentrated

in the hands of institutional investors. Among the most powerful are the trust departments of big banks.... About fifteen or twenty of the big banks through their trust departments could today mobilize voting control of a very large percentage of American industry....

The current estimate--it frightens me--is that by 1970 institutional investors will hold one-third of the stock of all corporations listed on the New York Stock Exchange. That adds up to working control." ([8], pp. 43-44, emphasis in the original)

While the evidence present here is consistent with the view that banks and other financial institutions may control many major corporations, in our view the control thesis is both too strong and misses a very important aspect of the situation.

Major financial institutions control the access to external financial capital for the major corporations and have extensive representation on the boards of the corporations. While this may not give the financial institutions across the board control of the corporations, it does along with the continuing and multifaceted nature of the relationship between corporations and banks, appear to put the banks in a position to substantially influence decisions making in individual corporations. Corporations borrow from banks and other financial institutions and must on a more or less continuing basis address the concerns of their lead banks.

Given the evidence on bank association with several corporations within an industry, what are likely to be the nature of the banks' concerns when dealing with an individual corporation? It seems reasonable to expect that when dealing with an individual corporation in an industry in which the bank has a substantial position

and relationship with several companies, the bank will make decisions on the basis of the probable impact of the transaction on the industry as a whole. That is, the major banks are uniquely situated in several industries to use their influence to guide individual corporations in the direction of the interest of the banks and the industry as a whole.

From this perspective the functional role of equity holdings by banks in several corporations in an industry is to certify that the bank will take an industry view point when dealing with each of its' client companies in the industry. The continuing and multifaceted relationship between banks and corporations may put banks in a position to influence the decision making in the corporations on a continuing basis. Control of access to additional financing may be used to put weight behind the bank's opinions and viewpoint.

The major problem is not bank control of individual corporations, though that may exist and be important, but rather the influence of large banks over several "competitive" companies in an industry. The data presented here suggests that the financial system, centered in a few large banks, may work to reduce competition and independent decision making across several industries in the United States.

The concentration of control over the access to financial capital in the hands of a few financial institutions has implications for how the market system will work. The anti-competitive impacts of the concentration of financial power may go well beyond the confines of the credit and equity markets themselves.

We suggest that the impacts on competition may reach into many markets where interlocked financial institutions, especially

interconnected banks, have substantial relations with several companies in an industry. The implications of financial concentration for how the economy will function are important and far reaching. The questions that existing financial concentration raise should be carefully considered in the legislative process determining the proper set of institutional restrictions on the banking system.

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APPENDIX B

97th Congress
1st Session

S. _____

To foster competition and provide
for fair and effective regulation
of the financial industry

IN THE SENATE OF THE UNITED STATES

_____, 1981

_____ introduced the following bill; which was
read twice and referred to the Committee on Banking, Housing
and Urban Affairs.

A Bill

To foster competition and provide for fair and effective
regulation of the financial industry.

Be it enacted by the Senate and House of Representatives
of the United States of America in Congress assembled,

Sec. 1. That section 22 of the Investment Company Act of
1940 (15 U.S.C. §80a-22), is amended by adding at the end
thereof the following:

"(h) Notwithstanding paragraph 'Seventh' of section 5136
of the Revised Statutes of the United States (12 U.S.C.
§ 24), sections 9, 20, 21, or 32 of the Banking Act of 1933
(12 U.S.C. §§ 335, 337, 378, or 78), or the Bank Holding

Company Act of 1956 (12 U.S.C. § 1841 et seq.), a bank, a bank holding company or a subsidiary thereof, savings and loan association, savings bank or a credit union --

"(1) may organize, sponsor, operate, control or render investment advice to an investment company (including a company which would be an investment company except for the provisions of section 3(c)(1) of this title); Provided, however, that such bank, bank holding company or subsidiary thereof, savings and loan association, savings bank or credit union shall have registered as an investment adviser pursuant to 15 U.S.C. § 80b-3."

"(2) may underwrite, distribute, sell or issue securities of an investment company; Provided, however, that the officers and employees of such bank, bank holding company or subsidiary thereof, savings and loan association, savings bank or credit union who sell such securities meet such standards with respect to training, experience and sales practices as the United States Securities and Exchange Commission or the National Association of Securities Dealers shall prescribe by regulation."

Sec. 2. That section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a)(4)) is amended to read in its entirety:

"The term 'broker' means any person engaged in the business of effecting transactions in securities for the account

of others, but does not include a bank, bank holding company or subsidiary thereof, savings and loan association, savings bank or credit union, except as provided in section 22(h) of the Investment Company Act of 1940."

Sec. 3. That section 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(5)) is amended to read in its entirety:

"The term 'dealer' means any person engaged in the business of buying and selling securities for his own account through a broker or otherwise, but does not include a bank, bank holding company or subsidiary thereof, savings and loan association, savings bank or credit union, except as provided in section 22(h) of the Investment Company Act of 1940, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business."

Sec. 4. That section 2(a)(6) of the Investment Company Act of 1940 (15 U.S.C. § 80a-2(a)(6)) is amended to read in its entirety:

"'Broker' means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank, bank holding company or subsidiary thereof, savings and loan association, savings bank or credit union, except as provided in section 22(h), or any person solely by reason of the fact that such person is an underwriter for one or more investment companies."

Sec. 5. That section 2(a)(11) of the Investment Company Act of 1940 (15 U.S.C. § 80a-2(a)(11)) is amended to read in its entirety:

"'Dealer' means any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, bank holding company or subsidiary thereof, savings and loan association, savings bank or credit union, except as provided in section 22(h), or an insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting or trading in securities, or owning or holding securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business."

Sec. 6. That section 3(a)(3) of the Investment Company Act of 1940 (15 U.S.C. § 80a-3(c)(3)) is amended to read in its entirety:

"(3) Any bank, except as provided in section 22(h), or insurance company; any savings and loan association, building and loan association, cooperative bank, homestead association or similar institution, except as provided in section 22(h), or any receiver, conservator, liquidator, liquidating agent, or similar official or person thereof or therefore, or any common trust fund or similar fund maintained by a bank exclu-

sively for the collective investment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; or any common trust fund or similar fund, established before June 22, 1936, by a corporation which is supervised or examined by State or Federal authority having supervision over banks, if a majority of the units of beneficial interest in such fund, other than units owned by charitable or educational institutions, are held under instruments providing for payment of income to one or more persons and principal to another or others."

Sec. 7. That section 202(a)(3) of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-2(a)(3)) is amended to read in its entirety:

"(3) 'Broker' means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank, bank holding company or subsidiary thereof, savings and loan association, savings bank or credit union, except as provided in section 22(h) of the Investment Company Act of 1940."

Sec. 8. That section 202(a)(7) of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-2(a)(7)) is amended to read in its entirety:

"(7) 'Dealer' means any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank,

bank holding company or subsidiary thereof, savings and loan association, savings bank or credit union, except as provided in section 22(h) of the Investment Company Act of 1940, or an insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as part of a regular business."

Sec. 9. That section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-2(a)(11)) is amended to read in its entirety:

"(11) 'Investment adviser' means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) a bank, bank holding company as defined in the Bank Holding Company Act of 1956 which is not an investment company, savings and loan association, savings bank or credit union, except as provided in section 22(h) of the Investment Company Act of 1940; (B) any lawyer, accountant, engineer, or teacher whose performance of such services is

solely incidental to the practice of his profession; (C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore; (D) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; (E) any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to section 78c(a) (12) of this title, as exempted securities for the purposes of the Securities Exchange Act of 1934; or (F) such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order."

SUMMARY OF THE BILL

The Bill amends the Investment Company Act of 1940 to permit banks, bank holding companies or their subsidiaries, savings and loan associations, savings banks, and credit unions to organize, sponsor, operate, control or render investment advice to an investment company, provided that the banking institution is registered as an investment adviser under the Investment Advisers Act of 1940. The Bill also permits banking institutions to underwrite, distribute, sell or issue securities of an investment company, provided that banking institution salesmen satisfy the training, licensing and examination requirements of the Securities and Exchange Commission and the National Association of Securities Dealers.

The Bill provides for corresponding regulation of corresponding activities. When banking institutions enter the field of organizing, sponsoring, operating or advising mutual funds, there is no difference between that activity and that of a non-bank mutual fund sponsor, organizer, controlling firm or adviser, sufficient to justify a different regulatory approach. Nor is there any reason to distinguish between bank and non-bank mutual fund underwriters, distributors, sellers or issuers. While the banking regulatory agencies may have available laws or regulations that could govern

portions of these new activities, the banking rules were designed to enhance the integrity of banking institutions, not to protect investors or to guard against abuses when banks enter the mutual fund business. Moreover, the banking agencies, including the Federal Reserve Board, Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board and the National Credit Union Administration Board, apply different regulations with varying degrees of expertise and enforcement vigor.

Entry of banking institutions into the mutual fund business is too important a step to undertake on the basis of an array of inconsistent regulatory obligations, administered by agencies that are unfamiliar with the field. Investors in bank-sponsored funds are entitled to the same degree of protection, to enjoy the same expertise and to obtain the same type of information from their advisers, as investors in non-bank sponsored funds. Any other treatment of bank-sponsored funds invites a conflicting hodge-podge of regulatory obligations which will tend to detract from the protection afforded investors, confuse the public, and lower confidence in the integrity of all collective investment media.

APPENDIX C

97th Congress
1st Session

S. _____

To foster competition and provide
for fair and effective regulation
of the financial industry

IN THE SENATE OF THE UNITED STATES

_____, 1981

_____ introduced the following bill; which was
read twice and referred to the Committee on Banking, Housing
and Urban Affairs.

A Bill

To foster competition and provide for fair and effective
regulation of the financial industry.

Be it enacted by the Senate and House of Representatives
of the United States of America in Congress assembled,

Sec. 1. That the Investment Advisers Act of 1940 (15
U.S.C. § 80b-1 et seq.) is amended by adding a new section
80b-3A following section 80b-3:

"80b-3A

"Notwithstanding paragraph 'Seventh' of section 5136 of
the Revised Statutes of the United States (12 U.S.C. § 24),

sections 20, 21, or 32 of the Banking Act of 1933 (12 U.S.C. §§ 377, 378 or 78) or the Bank Holding Company Act of 1956 (12 U.S.C. § 1841 et seq.), an investment adviser registered pursuant to 15 U.S.C. § 80b-3, which on October __, 1981, organized, sponsored, operated or rendered investment advice to an open-end investment company, or, such adviser's parent, affiliate, or subsidiary, upon filing a certificate of election with the Comptroller of the Currency, may exercise all the powers of a national banking association; provided, however, that such adviser, or such adviser's parent, affiliate or subsidiary, shall not be deemed a "national banking association" for the purposes of the McFadden Act, (12 U.S.C. §36) nor be deemed a "bank" or "bank holding company or subsidiary thereof" for the purposes of the Douglas Amendment to the Bank Holding Company Act (12 U.S.C. §1842(d)).

Sec. 2. That paragraph "Seventh" of section 5136 of the Revised Statutes of the United States (12 U.S.C. § 24), is amended by adding the words: "Except as provided in section 80b-3A of the Investment Advisers Act," before the words: "the business of dealing in securities and stock."

Sec. 3. That section 32 of the Banking Act of 1933 (12 U.S.C. § 78), is amended by adding the words: "Except as provided in section 80b-3A of the Investment Advisers Act," at the beginning of such section.

Sec. 4. That section 20 of the Banking Act of 1933 (12 U.S.C. § 377), is amended by adding the words: "except as provided in section 80b-3A of the Investment Advisers Act," before the words: "no member bank shall be affiliated in any manner."

Sec. 5. That section 21 of the Banking Act of 1933 (12 U.S.C. § 278), is amended by adding the words: "except as provided in section 80b-3A of the Investment Advisers Act," before the words: "to engage at the same time to any extent whatever."

SUMMARY OF THE BILL

The Bill would move a step closer to a truly "level playing field" in the financial services area by granting registered investment advisers to mutual funds (or, at the option of such adviser, the adviser's parent, affiliate or subsidiary) the powers of a national banking association. The Bill thus complements S. 1720, which would permit a variety of banking institutions to sponsor mutual funds.

As drafted, S. 1720 does not provide for securities firms to engage in the business of banking. Thus, for example, although S. 1720 would permit Citibank to sponsor mutual funds, it does not permit Merrill Lynch to engage in any banking function. The Bill would complement S. 1720 by providing for a reciprocal enhancement of the powers of registered investment advisers for open-end investment companies (i.e., "mutual funds"). Thus, just as banking institutions would be permitted to enter the mutual fund business -- a competitive field heretofore occupied solely by investment advisers and their investment companies -- registered investment advisers of mutual funds would be permitted to compete with banks in areas previously reserved to banks.

This type of reciprocal competitive opportunity is absolutely essential if banking institutions are not to be

given unconscionable competitive advantages in the financial industry.

For example, banks already have the ability to accept deposits and obtain deposit insurance, and have special access to the "discount window" and federal funds market as sources of "wholesale" money -- compared to the "retail" rates at which mutual funds and their advisers must borrow. Even with the enactment of this Bill, however, banks will continue to enjoy certain competitive advantages. For example, banks enjoy tax advantages, including the ability to reduce tax liabilities by deducting interest paid on funds borrowed to hold tax-exempt securities, and have been permitted to deduct their reserves against future loan losses from gross income. Banks have also been protected from rigorous competition by laws such as the McFadden Act which impose restrictions on interstate competition. Banks also possess a built-in advantage in marketing a new investment medium since they have a captive market in the form of their current, and easily accessible customers.

In short, the Bill provides for an enhancement of the powers of mutual fund investment advisers to complement the new powers proposed to be granted to banking institutions. This enhancement will enable the mutual fund industry to compete on a more fair (although still not equal) basis, with the financial and marketing might of the banking industry.

In addition, the McFadden Act and the Douglas Amendment, which prevent banking institutions from conducting a banking business in more than one state, have lead to the development of nationwide systems of correspondent banks through which the largest banks provide a variety of services to the smaller banks and their customers. As has been made clear through legislative proposals sponsored by large banks, it is contemplated that, if the Glass-Steagall Act is modified or repealed, these correspondent relationships will be utilized by the large banks to distribute securities products and services through a chain of local banks. In each community, these securities activities will be linked to the banking services provided by local banks to their banking customers.

Thus, even if advisers were granted national banking association powers, advisers arguably might be shackled by restrictions on interstate banking activities which the big banks have been able to overcome through their correspondent system. In order to mitigate this major competitive advantage, the Bill clearly exempts advisors from the restrictions on nationwide banking which are imposed by the McFadden Act and the Douglas Amendment.

A bank at work:

producing positive investment results

The Philadelphia National Bank's commingled equity fund for employee benefit trusts has out-performed both the Dow-Jones Index and Standard & Poor's Index for the 5 years ended June 30, 1975, as follows:

Total Return to Mutual Fund Shareholders		Compound average
PNB Stock (income reinvested)		Annual growth rate
PNB Philabank Stock Fund	+98.1%	+14.7%
Dow Jones Industrial Average	+57.8%	+9.6%
Standard & Poor's "500"	+55.8%	+9.3%

PNB offers a high level of experience and personalized service to meet the objectives of each fund. You'll find that PNB's investment management services are tailored to your needs and specific requirements. And we provide the specialized services of securities' and economic research, portfolio management and close personal account supervision. We are just the right size to do these things most efficiently and to make decisions with speed and flexibility.

To learn how these results were achieved, call Harry A. Dorian at (215) 629-4031.

PNB Philadelphia National Bank

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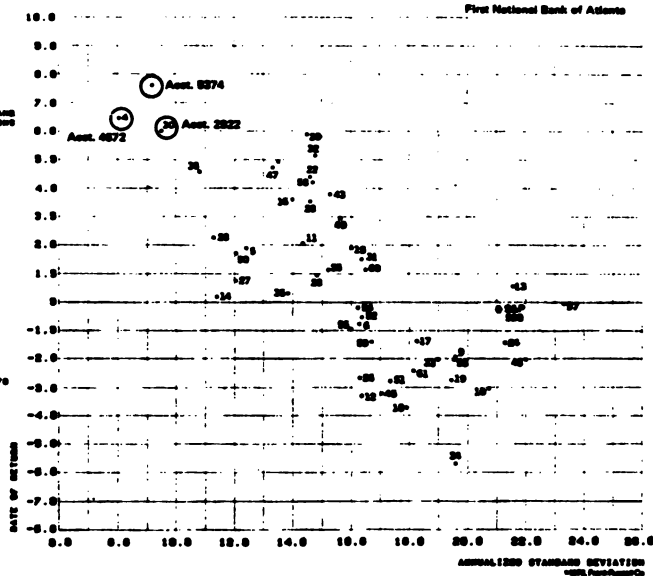
DECEMBER 1975

Our past is more than just performance. It's a philosophy.

RISK-RETURN PERFORMANCE COMPARISONS

ANNUALIZED
RISK-RETURN
PERFORMANCE
IN PERCENT

DATE SEPARATE
ACCOUNTS
OF PORTFOLIO
4-1-75 TO 3-31-78



For the past five years The First National Bank of Atlanta has consistently out-performed the other banks in the Frank Russell Survey. How so?

Well, the way we figure it, if we're going to optimize our clients' return, then we're going to have to conservatively manage the risks. Which is why we demand of

ourselves a consistently conservative investment posture. And as you can see by the chart this policy has served our clients well over the past five years.

For more information on how we can help you in the future, there's no time like the present to contact Fred Bets 404/588-6817.

THE FIRST NATIONAL BANK OF ATLANTA

Trust & Investment Department, 2 Peachtree St., N.W. Atlanta, Georgia 30303

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INSTITUTIONAL INVESTOR

A lot of fund managers are happy to equal the S&P average. We start there.

Over the most recent 5-year period, Central National Bank achieved an average 6% return on its Commingled Equity Fund for Employee Benefit Plans. That's well above the S&P average for 500 stocks.

The same kind of above-average performance was recorded for the most recent 3-year and 4-year periods, too.

Ranked fifth out of 72 equity pooled bank portfolios by the Frank Russell Co. Inc., we're proud to have out-performed some of the best known names in the

country. In fact, our record of performance clearly makes us a "little-known big name."

We employ multiple strategies. The unifying theme is a realistic appraisal of potential total return as related to risk, with an orientation toward quality growth companies.

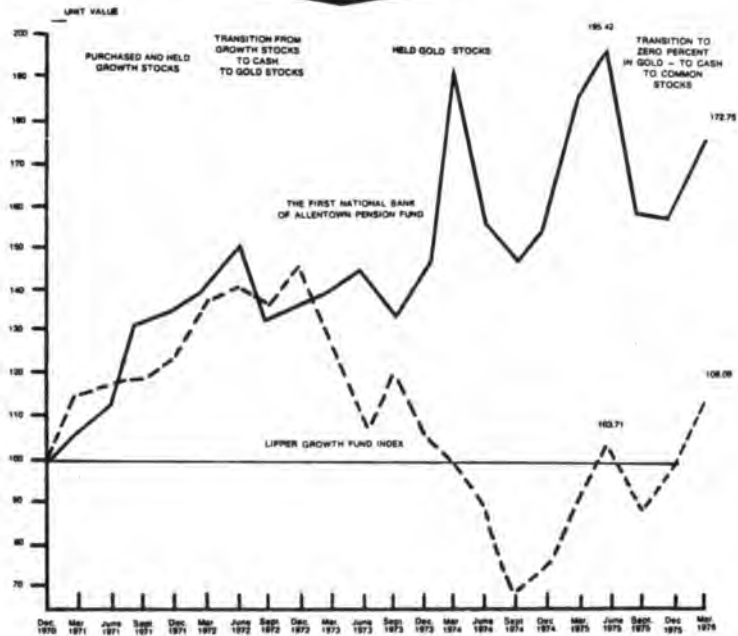
You probably don't know us yet, but if you begin looking at who are the consistent performers, you'll want to talk to us.

The person to start with is Chuck Meckes, Vice President, Trust Department. Call him at (216) 344-5023.

Central Bank
Central National Bank of Cleveland



Money management is where you find it, even in Allentown, Pennsylvania.



Wouldn't you agree?

For more information call Bill Snow
Investment Management Division
(215) 439-4360 or (215) 439-4209

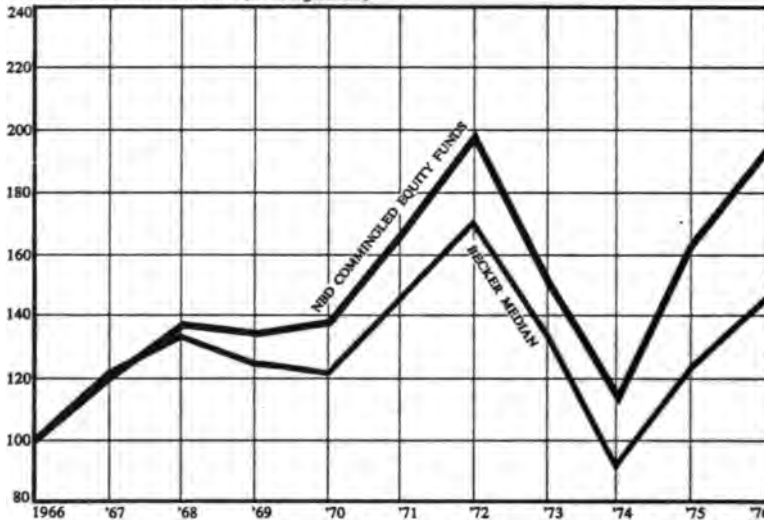
Lipper Growth Fund Index Adjusted December 1970 = 100.
The use of the Lipper index does not imply endorsement,
approval or analysis by the Lipper organization.



ALLENTOWN, PA.

Read between the lines.

Market Value Index 1967-1976 (Including Income)



OVER THE LAST DECADE, THE NATIONAL BANK OF DETROIT COMMINGLED EQUITY FUNDS HAVE OUTPERFORMED 97% OF THE BECKER UNIVERSE.

THIS RECORD IS A RESULT OF:

- Consistently superior performance from peak to peak, trough to trough, and over full market cycles.

- A uniquely disciplined approach to investment research and portfolio construction, utilizing modern asset valuation technology.

For some fascinating details on this process, and how it can benefit you, please contact **RICHARD L. FOERSTERLING**, Vice President, Trust Investment Department, National Bank of Detroit (313) 225-2820.



**Trust Division
National Bank
of Detroit**

Compare your Fixed Income Fund with the one we manage.

You want your fixed income manager to earn a high rate of return, avoid high risk and deliver consistently good performance.

Our pooled Fixed Income Fund for Employee Benefit Plans has averaged an 8.89 percent annual return over the last eight years while maintaining a low level of risk. In fact, only one manager out of the 82 bank-pooled fixed income funds measured by Frank Russell Co., Inc. delivered a higher return at a lower risk.

The fund managed by Detroit Bank & Trust has maintained a rate of return well above the median for the six cumulative periods measured by Russell (8 years, 5, 4, 3, 2, and 1), and in the top quartile four times out of the six, including the longest (8 years) and the shortest (1 year).

If your performance doesn't measure up to ours, shouldn't you turn to Detroit Bank & Trust as your next manager? We already have over a billion

dollars of employee benefit assets under management.

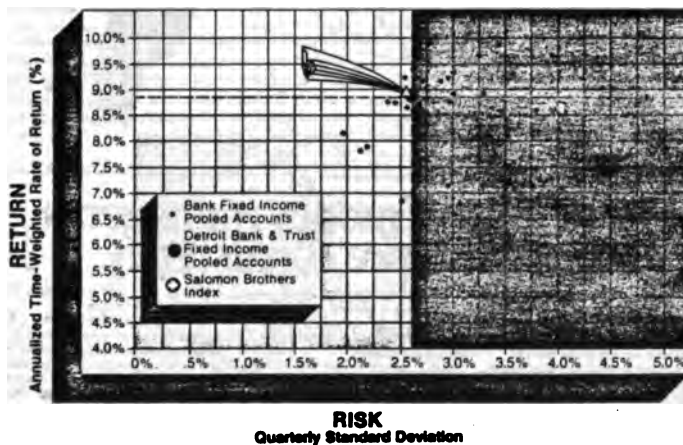
Call or write Terry Keating at (313) 222-3898, Detroit Bank & Trust, Box 59, Detroit, Michigan 48231.

you ought to know a
DETROIT BANK-er better



**DETROIT
BANK
& TRUST**

RISK VS. RETURN
Time-Period: 8 Year Performance (1-1-70 to 12-31-77)



The Indian head leads you to Detroit's first family of banks/DETROITBANK Corporation.



To choose a money manager, first measure consistency.

No fund can afford extreme volatility in the performance of its money manager, nor run the risks that come with desperate efforts to foresee short-term swings in the market.

Consider a prudent alternative. Examine National Bank of Detroit's "equity percent" ranking in the Becker Securities, Inc. universe for periods ending 1972 through 1977.

NBD outperformed, on average, 86% of other money managers for the six latest ten-year periods, exceeding the Becker Median yearly by an average of 2.1 percentage points.

NBD outperformed, on average, 86% of other money managers for the six latest seven-year periods, exceeding the Becker Median by 2.5 percentage points.

NBD outperformed, on average, 80% of other money managers for the six latest four-year periods, exceeding the Becker Median by 2.8 percentage points.

Consistency of this caliber, under all market conditions, is the product of NBD's disciplined valuation system. This system reduces subjective bias and makes it possible to anticipate the value of securities without

regard to type and to position your portfolio accordingly.

It will cost you nothing but a few minutes of your time to learn how these impressive results are achieved, and how we can put our capabilities to work for you. You begin with a telephone call to Richard Forsterling, Vice President at 313-225-2620.



Trust Division
National Bank
of Detroit

Take a longer look at investment performance...

In evaluating bank-pooled investment funds, the only true measure is to examine performance over a 3 to 5 year period. No bank in New Jersey surpasses First Jersey in performance over the current full economic cycle.

Here are the facts from a recent long-term independent survey by Computer Directions Advisors.

NEW JERSEY BANKS EQUITY FUND PERFORMANCE 12/28/78						NEW JERSEY BANKS FIXED INCOME PERFORMANCE 12/28/78					
LATEST YEAR 12/77-12/78		LATEST 3 YEARS 12/75-12/78		LATEST 5 YEARS 12/73-12/78		LATEST YEAR 12/77-12/78		LATEST 3 YEARS 12/75-12/78		LATEST 5 YEARS 12/73-12/78	
RETURNS		RETURNS		RETURNS		RETURNS		RETURNS		RETURNS	
NAT.	NAT.	NAT.	NAT.	NAT.	NAT.	NAT.	NAT.	NAT.	NAT.	NAT.	NAT.
PERCENT	RANK	PERCENT	RANK	PERCENT	RANK	PERCENT	RANK	PERCENT	RANK	PERCENT	RANK
First Jersey National Bank	8.7	54	43.4	11	48.8	15	First Jersey National Bank	2.9	48	30.3	8
Fidelity Union Trust Company	8.1	46	N/A	N/A	N/A	N/A	First National State Bank	7.4	189	21.2	110
First National State Bank	8.1	64	31.9	33	18.0	92	Garden State National Bank	2.5	92	25.7	12
Garden State National Bank	5.9	120	22.9	79	46.2	22	Midstate National Bank	1.8	92	39.1	17
Midstate National Bank	8.5	59	28.5	44	34.3	99	New Jersey National Bank	1.7	59	25.8	36
New Jersey National Bank #2	5.1	132	13.4	147	N/A	N/A	United Jersey Bank	.8	160	20.8	117
Summit & Elizabeth Trust	8.1	68	.9	201	19.2	85					
United Jersey Bank	7.3	92	33.8	28	28.1	29					
No. of Funds Surveyed - National		215		205		188		No. of Funds Surveyed - National		182	
F.J.N.'s Percentile - National		28.1%		5.4%		8.0%		F.J.N.'s Percentile - National		28.8%	
										5.2%	
										17.9%	

And the First Jersey's commingled investment fund has grown equally dramatically in size — 140.8% in common stocks (to 10,101,560.86), and 130.4% in fixed income holdings (to 6,000,686.15) since the end of 1974.



John J. Saueracker
Sr. V.P. Investment Dept.

That is the kind of growth that can be achieved only by outstanding and consistent performance over the long haul. It's the kind of performance that puts the First Jersey National Bank in first place in New Jersey. We invite you to participate in our success. A call to John J. Saueracker will introduce you to a concerned expert who will guide you to a plan that precisely fits your current needs and objectives for pension and profit-sharing fund investments. You can reach John at: (201) 547-7077.

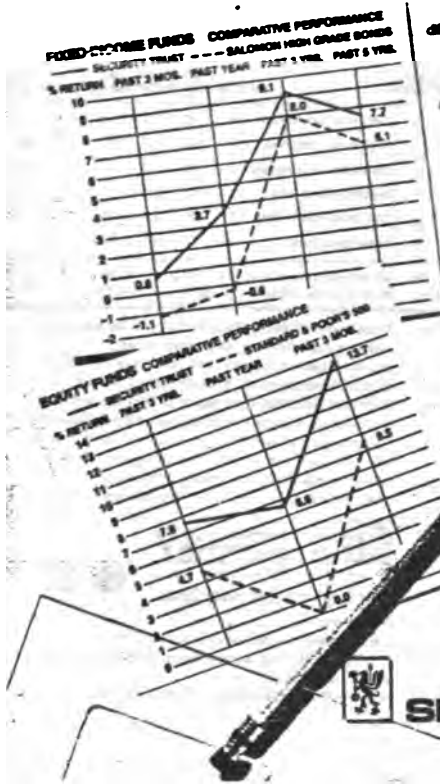
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YOU MAY BE SURPRISED BY WHAT YOU DISCOVER.



The instincts of professional money managers make the difference at Security Trust Company. Investment decisions based on a careful blending of intuitive judgment and modern investment theory are leading to favorable comparisons with random or computer-directed approaches to investment selection. If you use the adjacent graph to chart your pension fund's performance alongside ours, you'll see what we mean. Our money management philosophy is yielding exciting results.

Security Trust is a top quartile equity and fixed-income manager. A recent *Pensions & Investments* article comparing the performance of bank and insurance company pooled fixed-income and equity fund managers revealed remarkable results achieved by Security Trust. As previously reported in *PGI's Performance Evaluation Report (P.L.P.E.R.)*, Security Trust ranked in the top quartile of the fixed-income fund survey in four of the five time periods* measured and in three of those periods for the equity fund survey. Although not infallible, our money management philosophy has proven successful, as the charts demonstrate. Over the years, we have adhered to our fundamental principles, honing our skills, refining our judgments. As a result, Security Trust is today a top quartile equity and fixed-income fund manager.

*Ending June 30, 1976.

Our record could be your record. We believe that our management philosophy will continue to earn favorable results for our pension fund customers. If you're looking for a money manager with a uniquely successful approach to investment selection, then contact us for more details.

WRITE:

Security Trust Company, One East Avenue,
Rochester, New York 14638

CALL:

Clarence Ellsworth, Vice President, (716) 262-4571



SECURITY TRUST
Nearest your needs

A Security New York Bank

**THE IMPORTANT THING ISN'T HOW BIG YOUR
INVESTMENT MANAGER IS.
IT'S HOW BIG YOUR RETURN IS.**

As you've probably noticed, a lot of investment managers are playing the size game these days. Small independents want you to think that because they're smaller, they'll give you more personalized service. And large, investment center banks want you to think that because they're bigger, they'll give you a bigger return.

Well, obviously, the important thing isn't how big they are, but how good they are.

Take us, The First National Bank of Birmingham. We're right in the middle, between the small independents and the big money center banks, and we've been topping the industry standards for years.

During 1968-1977, for example, our corporate equity fund's rate of return was 8.2 percent. Versus a 3.6 for the Standard and Poor's 500.

And during 1973-77, our corporate equity fund's rate of return was a healthy 6.7 percent. Versus a minus 0.2 for the Standard and Poor's 500. While for 1977 itself, our edge was just as impressive: a plus 3.1 percent for us versus a minus 7.2 percent for the Standard and Poor's.

How do we get results like that? By resisting the temptation

to follow investment fads and sticking to a philosophy that's proven itself over and over again. Which is simply that if you consistently buy stocks that are undervalued and then sell them when they reach full value, the results will be consistently good.

As a result of that philosophy, we have one of the largest trust departments in the Southeast. And it's still growing. Yet you'll never find anyone, big or small, who'll give you better, more attentive service. For a sample, contact Davis H. Crenshaw, Vice President and Trust Marketing Officer, The First National Bank of Birmingham, P.O. Box 11007, Birmingham, Ala. 35228. Telephone (205) 326-5397.

**THE FIRST NATIONAL BANK
OF BIRMINGHAM**
AN ALABAMA BANK CORPORATION AFFILIATE
MEMBER FDIC



IT'S ABOUT TIME INVESTMENT MANAGERS WERE JUDGED ON THEIR SUCCESSES INSTEAD OF THEIR ADDRESSES.

In other words, it's about time that managers of employee benefit plans realized that you don't have to be located in one of the great investment centers to have a great investment record.

Take us, for example. The First National Bank of Birmingham. We're certainly not at the hub of the investment industry, yet our Trust Division has been outperforming the industry standards for years.

1972-76 is a good example. During that time, our Corporate commingled equity fund's rate of return was 7.9 percent versus only 4.9 percent for the Standard & Poor's 500. And for 1976 itself, our overall return was more than 14 points higher than the S&P—a hefty 38.5 percent.

How can a bank from Birmingham get this kind of results for its clients? Because despite all the myths and misunderstandings, it's still philosophy that determines investment success. Not geography.

And we have a philosophy that would be just as sound no matter where we had our office. Which is simply that if you consistently buy stocks that are

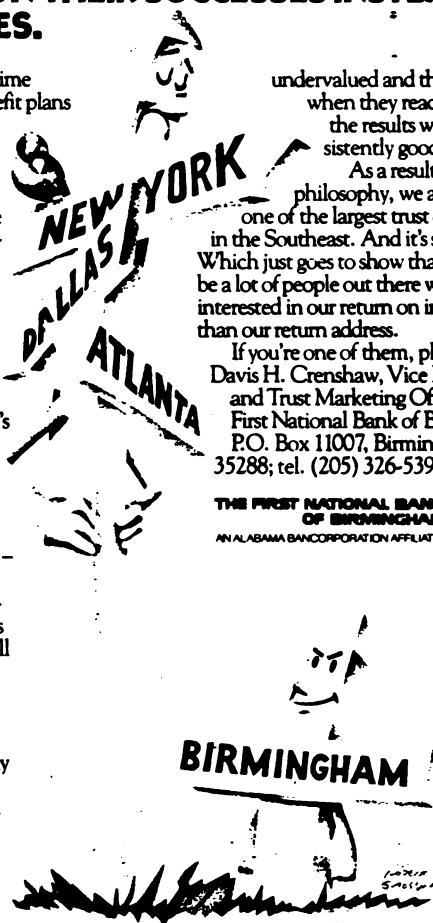
undervalued and then sell them when they reach full value, the results will be consistently good.

As a result of this philosophy, we already have one of the largest trust departments in the Southeast. And it's still growing. Which just goes to show that there must be a lot of people out there who are more interested in our return on investment than our return address.

If you're one of them, please contact Davis H. Crenshaw, Vice President and Trust Marketing Officer, The First National Bank of Birmingham, P.O. Box 11007, Birmingham, Ala. 35288; tel. (205) 326-5397.

THE FIRST NATIONAL BANK OF BIRMINGHAM

AN ALABAMA BANK CORPORATION AFFILIATE MEMBER FDIC



Active investing in the fixed-income market makes sense and money.

Becker

FUNDS EVALUATION SERVICE

INTERIM REPORT

NATIONAL CITY BANK • CLEVELAND, OHIO
NATIONAL CITY BANK INVESTMENT FUND FOR RETIREMENT TRUST — FIXED INCOME

TIME-WEIGHTED RATES OF RETURN AND RANKINGS
PERIODS ENDED JUNE 30, 1977

YOUR FUND W1298

	12 MONTHS PERCENT		24 MONTHS PERCENT		36 MONTHS PERCENT	
	RATE	RANK	RATE	RANK	RATE	RANK
FIXED INCOME YOUR FUND	13.2	12	12.5	10	11.9	11
MEDIAN	10.4		9.8		9.7	

This rate of return was accomplished through efficient management of our \$129 million Fixed Income Collective Fund for Retirement Trusts without impairing the quality of the portfolio. 98.45% of the market value is in Governments, Agencies and AAA Corporate Bonds. We feel this is the type of bond management you should be looking for. For further information or to arrange for a fact finding presentation, call (216) 861-4900 or write the Trust Group, New Business Division, National City Bank, 623 Euclid Avenue, Cleveland, Ohio 44114.

National City Bank
Cleveland • Ohio



It takes a broad range of investment skills to match retirement fund objectives today.

Here's how the people of First Chicago, with investment responsibility for \$8.8 billion, can provide diversification that's beyond the realm of other major money managers.

Mention diversification to most money managers and they'll tell you about their stocks and bonds. Mention it to First Chicago and we'll tell you a lot more.

We believe that extraordinary times call for extraordinary measures. To cope with today's erratic market behavior you need diversification that goes beyond conventional stocks and bonds, and beyond national boundaries. We've developed the skills to provide this full spectrum of diversification. And we have performance figures to prove its effectiveness. Here are a few examples.

Real estate to offset inflation.

A limited supply and increasing demand make choice income property an ideal investment for protecting assets from inflation. To provide easy access, First Chicago developed Real Estate Fund F, the oldest and by far the largest nationally diversified real estate fund, emphasizing outright ownership of properties, operated by any bank.

Properties are selected and managed by the Trust Department's own team of real estate specialists. As we invest only for funds we manage, we have no conflict as to allocation of choice properties. And investments are diversified both geographically and by property type: industrial buildings, office buildings, retail

centers and garden apartments.

Fund F has provided an annualized return of 8.2% since its inception in 1973. And for the 12 months ending June 30, return was 9.4%.

International securities to reduce volatility.

Since the securities markets of other countries tend to peak and valley at different times than our own, adding securities of overseas companies to your portfolio can reduce volatility. Yet this avenue of investment remains foreign to most major money managers.

Not to First Chicago.

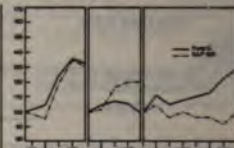
We were among the first to recognize the advantages of international diversification. In early 1973, our Trust Department established a London based staffed with a seasoned investment team. Today that team has management responsibility for over \$140 million in equity and debt investments.

Investments are diversified by country, type, industry and company. And our common stock emphasis is on well-managed, high quality corporations, especially those in sound, relatively high-growth economies with solid currencies.

Recent equity performance has been particularly favorable, as reflected by International Fund G. Since Oct. 76, unit value has increased 31.1% while the S&P 500 was up only 0.4%.

A market matching system that really matches.

Modern Portfolio Theory suggests, and we agree, that part of your employee benefit assets should be under passive index management. And First Chicago has developed a technology for it that's unique. Using one of three asset composition techniques, plus special trading strategies



Index of total return of our International Fund G compared with the S&P 500 during three market phases.

and dividend reinvestment approaches, we can create a portfolio to match virtually any rising common stock index, or an index designed especially to meet your goals. Our S&P 500 Index Fund, for example, has tracked this popular average within 30 basis points since the fund was introduced in July 1977.

Besides the benefits of broad diversification and close tracking, our Market Matching system also provides participants a worthwhile reduction in management and transaction charges.

And more.

These are only a few of the special investment tools we've developed to broaden diversification, improve performance and reduce overall portfolio volatility. Each is available as a special service, or as part of our complete retirement fund management program. If limited diversification isn't doing the job for you, why not look over the full spectrum at First Chicago? Write or call John P. Scott, Trust Officer, Trust Department, The First National Bank of Chicago, 3121 732-4152. Member FDIC.

Assistant Vice
President David L.
Greenlee, C.F.P. (left),
inspects corporate
headquarters building
owned and leased by
First Chicago's Real
Estate Fund F.



**The First
National Bank of Chicago**
Trust Department

How international diversification improves return and reduces volatility for Morgan's investment clients



Morgan officers at this international investment strategy meeting in London are (from left) Robert Rux and Nicholas Foster, New York; Karl Van Horn and Pierre Darnon, London; Hideo Dai, Tokyo; Carl Harbaway, New York; Walter Ziemer, London.

Alert pension fund sponsors, foundations, and other institutions are discovering the advantages of investment diversification by country. Through actively managed international portfolios they're getting improved return and lower volatility.

Many of them are clients of The Morgan Bank, which manages more than half a billion dollars in overseas equity and fixed-income securities for U.S. employee benefit plans. The chart at right shows the five-year performance of our commingled pension fund devoted to international equities.

At Morgan our investment approach traditionally has been international. Even when U.S. regulations made new overseas buying impractical, we kept up our research and our contacts. Today our international investment team includes professionals based in

London, Paris, Geneva, and Tokyo.

Geographic diversification that's actively managed and based on careful research broadens the range of investment options. It can smooth the cyclical bumps that are likely to jar a one-

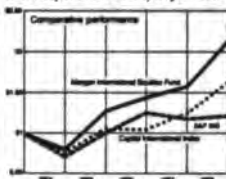


Chart shows value at year-end of \$1 invested Jan. 31, 1974 in Morgan's commingled pension fund for international equities, Standard & Poor's 500 Stock Index, and the Capital International Index for Europe, Australia, and the Far East. Reinvestment of income assumed.

economy portfolio. It can turn inflation differentials and currency fluctuations into opportunities rather than hazards.

But this kind of fund management takes special resources. Morgan's international investment managers draw on the knowledge of a multinational research team, the country-by-country analyses of the bank's international economists, and the currency judgments of its foreign exchange specialists in the world's money centers. Employing these strengths systematically, they build international portfolios that balance risk and return in accord with the client's specific objectives.

For more information on the advantages of international diversification, please write on your letterhead to Henry D. Cavarina, Vice President, Morgan Guaranty Trust Company, 9 West 57th Street, New York, N.Y. 10019.

The Morgan Bank



Vice President Howard Hudson, right, head of Morgan's fixed-income group, exchanges market information and viewpoints with the group's specialists.

Why pension fund sponsors are choosing Morgan for fixed-income management

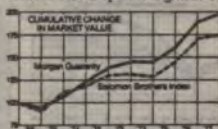
Increasingly, sponsors of employee benefit plans are choosing The Morgan Bank to manage their fixed-income investments. Here are some of the reasons why.

Morgan has a highly skilled group of investment managers working exclusively in the fixed-income field. This team of ten specialists has consistently achieved superior results, outperforming standard industry indexes. The chart compares their record over the past nine years with a leading index.

They are aggressive, active managers with well-defined goals — maximum return with minimum risk, consistency rather than volatility. Their strategy is to combine

high credit quality, a carefully controlled maturity structure, and skillful timing.

Employee benefit plans with fixed-income assets managed by Morgan gain added flexibility and diversification through use of our eight commingled funds. Each concentrates on a specific segment of



Morgan's fixed-income return on all employee benefit accounts compared with Standard & Poor's High Grade Corporate Bond Index since the index was established. Reinvestment of income assumed.

the fixed-income markets, including leasebacks, corporate private placements, mortgages, money-market investments, as well as publicly traded bonds. The newest specializes in foreign bonds, using Morgan's far-reaching international research capabilities. In fact, we are the leader in investing abroad.

For more about how Morgan's management of fixed-income assets can be tailored to your needs, send for the new edition of our detailed booklet, "The Management of Fixed-Income Investments for Employee Benefit Funds." Write on your letterhead to Assistant Vice President John L. Griffith, Morgan Guaranty Trust Company, 9 West 57th Street, New York, N.Y. 10019.

The Morgan Bank

EVEN IF YOUR PENSION FUND HAD A GOOD YEAR, TELL IT TO THE MARINE

As good as our performance is, Marine Midland doesn't believe that performance is the only way to judge management. We believe there are other important issues to consider in addition.

That's why you should ask yourself these questions—even if your pension fund had a good year.

Does the performance run hot and cold as the market runs hot and cold?

Will the investment philosophy that worked in the past be flexible enough to work tomorrow?

Do you feel comfortable with the long-term goals set up for you?

Understanding this total picture is the way we approach pension funds. And it's paid off.

Marine Midland had the highest rate of return on a 5-year basis for

collective equity funds among the largest 25 U.S. bank trust departments.¹

We also ranked first in 1-year performance. And number seven in the 3-year category. (All periods ending 12/31/77.)²

In fact, Marine Midland is one of the few major investment managers whose collective equity fund has beaten the Standard & Poor's average over the last 5 years.

If you want the kind of performance that goes deeper than just a good rate of return, tell it to the Marine. Contact Judith M. Trepanowski, Marine Midland Bank, 250 Park Avenue, N.Y., N.Y. 10017, telephone (212) 949-6649.

¹Trust Assets of Insured Commercial Banks, Joint Publication of Comptroller of the Currency, FDIC, and Federal Reserve Board, latest issue.

²Pensions and Investments' Performance Evaluation Report (P.I.P.E.R.)—Comparative Data through 12/31/1977.

MARINE MIDLAND BANK

Buffalo, New York City, Beirut, Bogotá, Buenos Aires, Caracas, Frankfurt, Hong Kong, Jakarta, London, Madrid, Manila, Mexico City, Nassau, Panama, Paris, Rio de Janeiro, Rome, São Paulo, Seoul, Singapore, Sydney, Tehran, Tokyo, Toronto.



Your company's employee benefit plan can't profit from a bad fit.

Most money managers prefer that your company's pension or profit sharing plan be designed to fit one of their standardized investment programs.

At First of Tulsa, we don't think that's in your best interest. That's why we design our investment and administrative programs to fit your individual plan.

We're specialists in stocks, bonds, oil, real estate, and the complexities of ERISA. And regardless of the size of your trust, we analyze your particular requirements, then tailor an investment and

administrative program to meet the performance goals of your plan.

This flexibility has enabled First of Tulsa's investment record to rank in the top 12% of those money managers surveyed nationwide by the Becker Securities Corporation.*

For more information about how our administrative and investment capabilities can help your company (and you), call collect for John Heard at (918) 586-5384. Or write First of Tulsa today.

*Pooled equity fund for employee benefit accounts. Equities only. 1-1-70 thru 12-31-76.

TRUST FIRST OF TULSA

Your First Resource

The First National Bank & Trust Company of Tulsa • Box One, Tulsa, Oklahoma 74193 • 918/586-5384

PENSION WORLD/NOVEMBER 1977

17

APPENDIX E

THE BEST RATE MONEY CAN BUY. EVERYDAY.

Introducing the Money Fund. From First Federal Savings. A flexible-maturity repurchase agreement that enables you to earn high daily interest without tying up your capital for a long period of time.

You begin with a minimum investment of \$15,000. Your principal and interest are then compounded daily from day after receipt to date of withdrawal. (Investments made on the day preceding weekends and legal holidays will begin to earn interest on the next business day.) Your Money Fund earns interest like no other investment you've ever made. That's because it's different.

The Money Fund is a repurchase agreement that represents a sale to you of a participation interest in a security held by First Federal. As a repurchase agreement, it is not insured by the Federal Savings and Loan Insurance Corporation, but the

securities are fully guaranteed as to principal and interest by the United States government or one of its agencies.

For the daily Money Fund rate call:

283-7283

Each day the interest earned will be an annualized rate established at 3:00 pm the previous day. Each day this rate will not be lower than 2% per annum under the daily rate that First Federal earns on its Federal Funds investments. (Federal Funds are cash reserves traded among financial institutions for overnight use.)

And the Money Fund makes it easy to get to your money. You can make additional investments or withdrawals of at least \$1,000 at any time. All without fee or penalty.

However, should your balance fall below \$15,000 it will earn interest at 8%. And should it fall below \$1,000, no interest will be earned. Your Money Fund account will again commence to accrue interest at the daily rate on the business day after the balance reaches or exceeds \$15,000.

Maturity. The Money Fund does not automatically renew, but the proceeds can be reinvested in a new Money Fund account or placed in a designated First Federal Check Plus, Check Club or Regular Passbook savings account with an initial deposit of \$100. So you never spend a day without earning interest.

To find out today's Money Fund rate, call First Federal's Money Fund line at 283-7283. Better yet, stop by any of First Federal's 14 convenient offices and ask about the Money Fund.

A serious investment. For the serious investor.

First Federal Savings of Indianapolis

MONEY FUND

One North Pennsylvania 283-1288 • Chicago 283-1277 • For day after tomorrow Shopping Center 283-1251 • New Plaza 283-1235 • Southern Plaza 283-1261 • Eastern Plaza 283-1275
• Northwest 283-1267 • 6254 Alameda Road 283-1286 • 7640 South U.S. 31 283-1271 • American Square Center 283-1234 • State Street 283-1272 • Washington Square
283-1289 • Washington 283-1276 • Greenwood Office, 1-78 and S.W. 283-729-1333 • The Choice at 88th and Alameda Rd. 283-1342

Announcing

Atlantic Federal Savings Money Fund!

A unique investment opportunity for Floridians seeking short-term, variable-yield investments without tying up funds for long periods, without penalty for early withdrawal, and without brokerage fees or service charges.

AFSMF (Atlantic Federal Savings Money Fund) is an investment opportunity offered by Atlantic Federal Savings & Loan and secured by an interest in obligations issued or backed by the U.S. Government or by a U.S. Government Agency. The investment is not a savings account or a deposit, nor is it insured by the Federal Savings and Loan Insurance Corporation.

AFSMF interest is paid from the date of receipt to the date the funds are withdrawn. Interest rates may fluctuate daily based on investments available to the Association on the purchase date and each date thereafter. Having the rates fluctuate with the market eliminates the need for investors to shop for high rates. The high rates come to you!

AFSMF minimum investment is only \$1,000. Interest earned on your investment will be automatically credited monthly to your Atlantic Federal interest-earning checking account or regular savings account.

Legal residents of Florida are eligible to become investors. The maximum term of this agreement is 60 days and interest is not paid on or after the date of repurchase ... at which time the principal and final interest payment will be credited to your Atlantic Federal account.

Hot Line... For current 6 Month, 2 1/2 Year Certificate, and Money Fund Rates... Phone: 764-RATE (Broward), 535-RATE (Dade), 372-RATE (Deerfield to Delray), 848-RATE (Boynton Beach to Jupiter).

AFSMF FEATURES

- Short-term, variable-yield
- No penalty for early withdrawal
- No brokerage fees or service charges
- Secured investment

14.25 %

May 11, 1981

\$1,000.00

Minimum

Every \$100 investment does not qualify for next savings account offer.



Atlantic Federal
Savings and Loan

Donald V. Sorensen, Chairman President
Over 40 Offices in Dade, Broward and Palm Beach Counties
For information call: Dade 944-0209 • Broward 764-2111
Palm Beach 958-5711 • 431-7825



*You get
that little
something extra*

Now there's a money fund with real-time interest and full-time security

The Bay View Federal Money Fund.

Bay View Federal Savings & Loan now has an ideal investment for the average investor. It's a \$2500 money fund that pays you "Real-Time" interest. You earn the daily high interest rate, not a fixed rate. That means if daily interest rates go up, so do your earnings. Should interest rates go down, you're not locked in. You can take your money out without penalty. Additionally, you can write checks against your funds through a Bay View interest earning checking account simply by transferring funds from your money fund to your Bay View checking account.

Investing without fear.

Where some investments have far-away sounding names and Eastern addresses, the Bay View Federal Money Fund is right here where you live. There's no mystery involved. To open your money fund just drop by your local Bay View Federal Savings branch office. You'll find our people eager to serve you and very professional.

A perfect beginning.

Our new money fund is an excellent way for you to meet us if you're not a regular Bay View customer. You'll discover very quickly that Bay View Federal understands your needs and is an excellent financial partner. Our money fund isn't a savings account or a deposit, but it's a terrific way to get to know us and earn daily high interest. And you can renew your Bay View Federal Money Fund every eighty-nine days.

Investment security.

Once you've started your money fund investment, your funds are secured by U.S. Government obligations and managed locally by Bay View Federal Savings, a federally chartered, federally regulated financial institution. And although the Bay View Federal Money Fund is not insured by the Federal Savings and Loan Insurance Corporation, you'll have the confidence of knowing your money is available and being looked after by a financial institution that's been serving Northern California residents for over 70 years.

Open a Bay View Federal Money Fund this week.

There has never been a better time for the average investor to earn high interest with a minimal investment. Our \$2500 money fund has been designed with you in mind, the average investor. It's local, so you know who you're dealing with. It pays you daily high interest, not a fixed rate. You can write checks against it and take your money out without any penalty. Telephone or drop by the Bay View Federal Savings & Loan in your area this week. Open a Bay View Federal Money Fund. You'll earn daily high interest on a real-time basis without full-time worry.



If you live in the West,
you should have a Bay View.

South San Francisco: 270 Grand Ave., South San Francisco, (415) 553-2121 / Millbrae: 475 El Comite Real, Millbrae, (415) 497-1500 / Walnut Creek: 1323 N. Main Street, Walnut Creek, (415) 944-3007 / Concord: 11150 48th Street, Concord, (415) 827-0300 / Lafayette: 494 Lafayette Ave., Lafayette, (415) 924-3313 / San Ramon: 3438 San Ramon Valley Blvd., San Ramon, (415) 456-4475 / Bay View: 1047 Third Street, San Francisco, (415) 822-7651 / Potrero-Grove: 2550 Potrero Avenue, San Francisco, (415) 281-1521 / Alhambra: 2008 Main Street, San Francisco, (415) 826-6400 / Potrero Square: 1070A Mission Street, San Francisco, (415) 398-1111 / Lakeside Village: 2008 Ocean View, San Francisco, (415) 398-1111 / Fisherman's Wharf: 377 Bay Street, San Francisco, (415) 398-1111 / Market Plaza: 1 Market Plaza, San Francisco, (415) 777-3033 / 24th St. Mission: 24th St. Mission, San Francisco, (415) 824-0800

ADMINISTRATIVE OFFICES: 2221 S. EL CAMINO REAL, SAN MATEO, CA 94403 PHONE: (415) 522-7300

Washington Mutual announces Flexifund™

Flexifund works like a money market fund. You earn a high rate of interest that fluctuates weekly. You have the freedom to get out anytime from 8 to 84 days without a penalty. And you can get in for as little as \$3,000 as often as you like.

Flexifund lets you put as little as \$3,000, or as much as you like, in an investment of Washington Mutual. Flexifund enables you to earn principal hereafter. One is a fluctuating rate of interest that helps keep pace with inflation. The other is an escape feature that lets you get out anytime after 8 days and receive 84 days without losing any interest and without paying a penalty.

Interest rates posted weekly on Mondays

Every Monday, Washington Mutual will post the current week's rate for Flexifund. Let's say you put in \$3,000 on Monday. By next week you will have been in it for 8 days. If you don't like next week's interest rate, or if you think you can do better elsewhere, you simply cash in your Flexifund. You get back your principal plus the interest which has accrued for the eight days.

On the other hand, you may decide to stay in. Either because you like next week's rate or because you can't do better elsewhere. In that case, you just stand pat and do nothing. You will automatically earn each week a new rate.

Can you get out on a Wednesday or Friday?

No. You can cash in your Flexifund anytime on any business day after you've been in 8 days and hold on the 84th day. When you cash in you collect interest in full for every day, including Sunday, Monday and holidays, right up to the day you withdraw. All you have to remember is that you earn a different rate of interest for each week you've been in Flexifund. Since you have a clear option to get out

anytime after 8 days you will never be disappointed or surprised.

Getting the best rates for your money market history

Flexifund is designed for that part of your savings in which you want to earn the best interest rates without running the risks of the stock market, the bond market, the gold and other markets, and mutual funds. But to earn those high rates you have to keep a sharp eye on who's paying what.

There may be a week when we may not be paying the highest rate and you may want to move your money market money to another bank or to a well-managed mutual fund. Washington Mutual's Flexifund gives you that flexibility. Anytime from 8 days and up to 84 days you can sign out with all the interest accumulated to date.

Can businesses cash in on it?

Indeed they can. Flexifund is open to proprietorships, partnerships and corporations as well as individuals. If you have a business with a minimum 8-day line or a surplus you'd like to put your hands on fast if you need it, Flexifund is a perfect place to park your money for the 84 days. When you need it, your money is as close as your nearest Washington Mutual branch.

Two catches. But then there's always a catch.

What if Flexifund investments are backed by an interest in U.S. Government securities—the catch in the catch—the

Federal Deposit Insurance Corporation will not extend its insurance to cover it. It's hard to believe since it's all the same Government, but that's the way the Government works. Nevertheless and legally, Flexifund does not carry the guarantee of the F.D.I.C.—an insurance for savings and insured Certificates of Deposit do. But then your money market mutual funds aren't insured anywhere else either.

You have to weigh whether or not you want your money market money insured at Washington Mutual or in a Federal mutual fund.

The other catch is a \$3.00 service charge every time you decide to come in, but no charge or loss of interest payments.

No other catches?

No other catches. Washington 25% charge. No waiting.

What do you do now?

If you like the idea of putting your money market money insured at Washington Mutual, and you like the week's interest rate, then move your money to our money market money in Flexifund today. Same with 84-day line or surplus, if you want a business. You'll have your interest from \$3,000—no charge, no waiting, no catch. Washington Mutual Flexifund.

Washington Mutual
Washington Mutual Savings Bank

NEW YORK TIMES, Wednesday, May 20, 1981

15% interest

on as little as \$1000
For 10 to 89 days.

NO RISKS. NO PENALTIES. NO FEES.

Announcing the
CFF COUNTY FEDERAL INVESTORS FUND

It pays Money-Market rates for investments of \$1000 or more, and you can withdraw at anytime, after the 10th day, without penalty!

TOP-INTEREST, SHORT-TERM INVESTMENTS.
COUNTY FEDERAL INVESTORS FUND allows individuals, corporations, partnerships, or organizations to purchase an agreement backed by a U.S. Government or Government Agency Security, for a term of 10 to 89 days, which County Federal guarantees to repurchase at anytime, repaying your original investment plus total interest earned to date.

MINIMUM INVESTMENT IS \$1000 OR MORE...
In multiples of \$100. The Fund requires that you open a no-cost N.C.W. checking account with a \$25 balance, or a Regular Passbook account to facilitate repurchase. (No notice of maturity will be given.)

GUARANTEED RETURN WITH NO PENALTY FOR EARLY WITHDRAWAL.
The Fund is secured and backed by the U.S. Government or U.S. Government Agency Security. Since it is not a savings account, it is not insured by

the FDIC. County Federal guarantees that your investment and all earned interest will be returned at anytime, after 10th day. No partial withdrawals or additions.

HIGH-INTEREST RATE GUARANTEED BY COUNTY FEDERAL.
The Fund guarantees the rate established at the time of your investment for up to 89 days regardless of market fluctuations. Rates on subsequent issues will be determined by market conditions.
This is a limited subscription which may be withdrawn or redeemed at any time without penalty.

CFF COUNTY FEDERAL SAVINGS

MANHATTAN
120 W. 42nd Street, 10th Floor, New York, N.Y. 10018
Phone: 212-693-1200, 212-693-1201, 212-693-1202, 212-693-1203, 212-693-1204, 212-693-1205, 212-693-1206, 212-693-1207, 212-693-1208, 212-693-1209, 212-693-1210, 212-693-1211, 212-693-1212, 212-693-1213, 212-693-1214, 212-693-1215, 212-693-1216, 212-693-1217, 212-693-1218, 212-693-1219, 212-693-1220, 212-693-1221, 212-693-1222, 212-693-1223, 212-693-1224, 212-693-1225, 212-693-1226, 212-693-1227, 212-693-1228, 212-693-1229, 212-693-1230, 212-693-1231, 212-693-1232, 212-693-1233, 212-693-1234, 212-693-1235, 212-693-1236, 212-693-1237, 212-693-1238, 212-693-1239, 212-693-1240, 212-693-1241, 212-693-1242, 212-693-1243, 212-693-1244, 212-693-1245, 212-693-1246, 212-693-1247, 212-693-1248, 212-693-1249, 212-693-1250, 212-693-1251, 212-693-1252, 212-693-1253, 212-693-1254, 212-693-1255, 212-693-1256, 212-693-1257, 212-693-1258, 212-693-1259, 212-693-1260, 212-693-1261, 212-693-1262, 212-693-1263, 212-693-1264, 212-693-1265, 212-693-1266, 212-693-1267, 212-693-1268, 212-693-1269, 212-693-1270, 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MASSAU

ROCKVILLE CENTRE 53 R. Park Ave. 11570 (at LIRR Sta.)
 ROCKVILLE CENTRE BRANCH 688 Surrogate Highway 11570
 VALLEY STREAM 720 S. Franklin Ave. 11580 (at LIRR Sta.)
 VALLEY STREAM BRANCH 130 E. Surrogate Highway 11580
 VANHOUSA 3385 Park Ave. 11785 (at LIRR Sta.)
 LEWISTON 3105 Hempstead Turnpike 11785
 GARDEN CITY 1150 Franklin Ave. 11530
 LAWRENCE 381 Rockaway Turnpike 11580

SUFFOLK

COMBRACK 6885 Jamaica Turnpike 11725
 COMBRACK ROAD 112 (Pine Point Shopping Ctr.) 11727
 NORTH FARMINGBORO 716 Route 112, North Farmington 11772

NEW YORK CITY

BROOKLYN—FLATBUSH 1330 Kings Highway 11220
 QUEENS—NEW CANNON HILLS 75-21 Main St. 11367
 QUEENS—ASTORIA 30-27 Steinway St. 11103
 MANHATTAN—EAST 125 Madison Ave. (at 58th St.) 10022
 MANHATTAN—WEST 124 West 42nd St. (at 6th Ave.) 10036

UTICA AREA

UTICA 236 Genesee Street 13402
 WEBSTER 324 Prospect Street 13280
 WATFORD 65 Ontario Blvd. 13402



COUNTY FEDERAL SAVINGS

AND LOAN ASSOCIATION
Assets in excess of one billion dollars and growing



COUNTY FEDERAL INVESTORS FUND

**New, High
Money-Market Rates
on as little as**

\$1000

for 10 to 89 days.

- NO RISKS • NO PENALTIES
- NO FEES



**A NEW INVESTMENT FUND FROM COUNTY FEDERAL
THAT PAYS MONEY-MARKET RATES ON \$1000 OR MORE
... AND YOU CAN WITHDRAW AT ANY TIME AFTER
THE 10th DAY WITHOUT PENALTY.**

**TOP-INTEREST, SHORT-TERM
INVESTMENTS.**

COUNTY FEDERAL INVESTORS FUND allows individuals, corporations, partnerships, or organizations to purchase an agreement backed by a U.S. Government or Government Agency Security, for a term of 10 to 89 days, which County Federal guarantees to repurchase at anytime, repaying your original investment plus total interest to date.

**MINIMUM INVESTMENT IS
\$1000 OR MORE...**

In multiples of \$100. The Fund requires that you open a no-cost N.Q.W. checking account with a \$25 balance, or a Regular Passbook account to facilitate repurchase. (No notice of maturity will be given.)

**GUARANTEED RETURN WITH NO
PENALTY FOR EARLY WITHDRAWAL.**

The Fund is secured and backed by the U.S. Government or U.S. Government Agency Security. Since it is not a savings account, it is not insured by the FSUC. County Federal guarantees that your investment and all earned interest will be returned at anytime, after 10th day. No partial withdrawals or additions.

**HIGH-INTEREST RATE GUARANTEED
BY COUNTY FEDERAL.**

The Fund guarantees the rate established at the time of your investment for up to 89 days regardless of market fluctuations. Rates on subsequent issues will be determined by market conditions.

This is a limited subscription which may be withdrawn or modified at anytime without notice.

Available at any County Federal office listed on reverse.

An Exceptional Investment Opportunity.

The Charter Investment Fund.

It's the newest commitment from American Charter. 12% on \$1000 for 89 days, guaranteed. With no brokerage fees. No service charges. And no risk.

American Charter has developed an exceptional investment opportunity for individuals and businesses. It's called the Charter Investment Fund, and offers very high, short term returns without the normal risks.

It is a "Repurchase Agreement" secured by a U.S. Government or U.S. Government Agency Security. The term of the Charter Investment Fund is 89 days and certificate denominations are available for as little as \$1000. At maturity we will transfer to any American Charter checking or statement savings account your original investment, plus the full 89 days interest.

**NO FEES.
NO CHARGES.
GUARANTEED RATE.**

While the Charter Investment Fund is fully secured by a U.S. Government or U.S. Government Agency Security, it is not a traditional savings account and therefore is not insured by the Federal Savings & Loan

Investment	Annual Interest Earned
\$1000-4999	Guaranteed interest rate for 89 days 12.00%
\$5000 and up	Guaranteed interest rate for 89 days 12.50%

The rate on future Charter Investment Fund offerings may change, without notice, subject to market conditions. This investment is available to Netherlands residents only.

American Charter guarantees that your investment is fully protected, and at maturity you will receive both your principle and interest.

Further, even if you elect to redeem your investment prior to its maturity, there will

be no brokerage fee, or service charge. However, since interest is paid only at maturity, you will receive your original investment without interest.

Importantly, no matter what the size of your investment, the rate at which you purchase your Charter

Investment Fund participation will be guaranteed for its full term (89 days) regardless of any declines in the market.

**AMERICAN
CHARTER**
Federal
Savings and Loan
Association
A New Commitment to You

For further information on this exceptional opportunity, please call, stop by or complete and mail the coupon to your nearest American Charter office. The Charter Investment Fund: our newest commitment to meeting your investment needs.

Indicate to me check for \$1000.00
to invest in units in shares in the
Charter Investment Fund
I understand that the Charter Investment Fund is a repurchase agreement secured by U.S. Government or U.S. Government Agency Security. I agree to the full term of 89 days and understand that the interest rate is guaranteed for the full term of 89 days. I understand that the rate on future Charter Investment Fund offerings may change, without notice, subject to market conditions. This investment is available to Netherlands residents only.

**AMERICAN
CHARTER**
Federal
Savings and Loan
Association

I am committed to this
investment in the Charter Investment Fund.

**American Charter's
Charter Investment Fund**

Name: _____
Address: _____
City: _____ State: _____ Zip: _____
Phone: _____
Business Phone: _____
Please send me the Charter Investment Fund certificate for \$1000.00. I understand that the interest rate is guaranteed for the full term of 89 days. I understand that the rate on future Charter Investment Fund offerings may change, without notice, subject to market conditions. This investment is available to Netherlands residents only.

I wish to open a new American Charter account (Check Here)
☐ I understand that the Charter Investment Fund is a repurchase agreement secured by U.S. Government or U.S. Government Agency Security. I agree to the full term of 89 days and understand that the interest rate is guaranteed for the full term of 89 days. I understand that the rate on future Charter Investment Fund offerings may change, without notice, subject to market conditions. This investment is available to Netherlands residents only.

Signature: _____ Date: _____

Financial Federal's Investors Group Fund!

**No Risk, No Penalty, No Fee Investing
for Those Who Want The Market Rates of A
\$10,000 Investment for Only \$1,000**

Short Term, High Interest Investing

Financial Federal's Investors Group Fund is a special investment opportunity for both individuals and businesses. It is basically a "Repurchase Agreement" where you may purchase a share of a US Government or US Government Agency Security from Financial Federal Savings who agrees to buy it back at the end of the term, not to exceed 89 days. You will then be paid your original investment plus total interest earned to date. Minimum investment in the Investors Group Fund is \$1000. A \$100 Regular Passbook Savings or a \$100 Interest-bearing Checking Account is required if you do not already have one.

Guaranteed Return With No Penalty for Early Withdrawal

Because the Investors Group Fund involves the purchase of a share of US Government or US Government Agency Security and is not an actual savings account, your investment is not insured by the Federal Savings and Loan Insurance Corporation. It is, however, backed and secured by the US Government or US Government Agency whose share you did have purchased.

Financial Federal Savings guarantees that your total investment plus all interest earned will be returned to you at any time, even before the end of the 89 day term, with absolutely no penalty for early withdrawal.

Your Interest Rate is Guaranteed for up to 89 Days

The rate established at the time of your purchase in the Investors Group Fund will be guaranteed for up to 89 days, regardless of market fluctuation. Financial Federal Savings will maintain competitive rates on a continuing basis, but reserves the right to raise or lower rates on new issues as dictated by market conditions.

Investors Group Fund. Consider the Advantages.

- Guaranteed high interest
- Term(s) up to 89 days
- No penalty for early withdrawal
- Ownership of a share of US Government or US Government Agency Security
- No brokerage fee or service charge for purchase of shares

We encourage you and your business to inquire about the Investors Group Fund at one of Financial Federal's four conveniently located offices.

Minimum Investment	Annual Earned Interest
\$1000-\$2900	Guaranteed Interest Rate For Up To 89 Days 11%
\$3000-\$5900	Guaranteed Interest Rate For Up To 89 Days 11.5%
\$6000 or More	Guaranteed Interest Rate For Up To 89 Days 12%



Olympia Fields	Calumet City	Joliet	Chicago Ridge Mall
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**Investors Group Fund...
Exclusively at Midland Financial**

4406, 1215 Southern Boulevard Investment Group Fund Southern Financial Group & Trust 1215 Maple Street St. Joseph, Kansas 64501 Kansas, 64501 (913) 882-1000	Midland Financial Investors Group Fund	File (Indicate by check) ☐ New Fund ☐ Existing Fund
Issued on this date 01/28/82 (month/year) to participate in the following investment Group Fund(s) as follows:	Name _____ Address _____ City _____ State _____ Zip _____ Social Security No. _____ Tax ID No. _____	I am an individual who is ☐ an individual investor ☐ an individual who is not an individual investor

**We encourage you and your business to inquire about the Midland Investors
Growth Fund at the Midland Financial Center nearest you.**



525 Main St. / Astoria / 213-8664 / Fred Surice, Manager
4000 1st Ave. / Astoria / 213-8790 / Pam Moore, Manager

"No kidding" George Brett



13.00%* GUARANTEED
INTEREST FOR
UP TO 89 DAYS!

MINIMUM INVESTMENT	ANNUAL EARNED INTEREST	
\$1000—\$4999	Guaranteed Interest Rate Per Up to 99 Days	12%
\$5000 and up*	Guaranteed Interest Rate Per Up to 99 Days	13%

- Terminal up to 90 days.
- Guaranteed high interest rate.
- Liquidity at any time.
- No penalty for early withdrawal.
- No brokerage fee or service charge.

Money Savings Liquid Asset
 Paid in a special investment for both individuals and businesses. It is a "Repurchase Agreement" involving a U.S. Government or U.S. Government Agency Security. Money Savings repurchases the agreement at the end of the term, not an amount.

30 days. You will then be paid your original investment plus total interest earned to date. Home Savings Liquid Asset Fund Certificates are available in denominations of \$1000 or more.

Home Savings Liquid Asset Fund is a "Repurchase Agreement," involving a U.S. Government or U.S. Government Agency Security and is not an actual savings account. This investment is not insured by the Federal Savings and Loan

Money Savings Association guarantees that your total investment, plus all interest earned, will be paid to you at maturity, even before the end of the 60 day term, with absolutely no penalty for early withdrawal.

The rules established in the state of your purchase of a Home Savings Liquid Asset Fund Certificate will be government set for up to 99 days, regardless of market fluctuations. Home Savings will maintain competitive rates on a continuing basis, but reserves the right to raise or lower rates on new issues as dictated by market conditions.

Investments in Home Savings Liquid Asset Fund are "Representative Agreements" involving a U.S. Government or U.S. Government Agency Security and are not insured by the Federal Savings and Loan Insurance

[illegible]

Now \$1,000 buys what \$10,000 used to

High interest.
It used to take \$10,000
and 6 months of hard labor in
Current Rate* a T-Bill Account to
14.00% earn it. But now, you
Easy Money Fund can get the same
kind of high interest with
a mere \$1,000. In 89 days.

	Minimum	Term
T-Bill Certificate	\$10,000	180 Days
Allstate Savings Easy Money Fund	\$1,000	89 Days

Quite a difference in
numbers, but very little dif-
ference on the bottom line.

It's an innovative idea
from Allstate Savings called
the Easy Money Fund. An
investment opportunity
secured by the U.S. Govern-
ment or U.S. Government
Agency securities. (This fund
is not a savings account or
deposit and is not insured
by the Federal Savings and
Loan Insurance Corporation.)

Your interest is guaran-
teed when funds are held
to maturity.

To get in on an Easy
Money Fund, bring in
\$1,000 (or more if you'd like,
in multiples of \$100) along
with a \$100 minimum to
open an Easy Money Check-
ing Account.

So why not grab your-
self a good buy?

Allstate Savings and Loan Association, a member of the Sears Family. 100 branches nationwide, over \$3 billion in assets.

*Annual earned interest. Rate subject to change.

Apex: 7327 Soquel Drive, Felton 9255 Highway 9, San Jose 2530 Alum Rock Ave., 1273 Blossom Hill Rd., 3510 Leigh Ave., 1304 Saratoga Ave., 235 South First St., 5009 Snel Ave., Santa Clara 2500 Pruneridge Ave., Saratoga 12945 Saratoga-Sunnyvale Rd., Argonaut Shopping Center.

Because unlike the cost
of everything else, the cost of
making money just got lower

Allstate Savings Easy Money Fund

Enclosed is my check for \$_____ (minimum \$1,000) to purchase an Easy Money Fund plus \$_____ (minimum \$100) to open my Easy Money Checking Account to participate in Allstate Savings Easy Money Fund secured by the United States Government or United States Government agency securities under agreement to repurchase. I understand my investment will be liquid in yield a rate of interest prevailing on the date of receipt by Allstate Savings for a period not to exceed 89 days. My investment is contingent upon my agreement to the terms of the Easy Money Fund which are stated on the confirmation notice to be sent to me at the address indicated.

Visit us: Allstate Savings, 701 N. Second Blvd., Gardena, CA 90243. Attn: Easy Money Fund, California Residents only.

Name _____

Send Separate No. _____
or on L.D. No. _____

Name _____ (if minor)

Send Separate No. _____
or on L.D. No. _____

Address _____

City _____ State _____ Co. _____

Home Phone _____ Business Phone _____

Please use my existing Easy Money Checking Account or Statement Savings Account # _____ for deposit of principal and interest at the end of my term.

If you have no existing account type as shown above, please complete below:

☐ I wish to open a new Easy Money Checking Account (minimum deposit \$100, enclosed within) or _____ (see locations listed below) - or new

☐ A new Statement Savings Account for business accounts - (minimum deposit \$100).

Signature 1. _____ Date _____

Signature 2. _____ Date _____

Mail check orders to: Allstate Savings

Allstate Savings
Money made easy.

Announcing World's Secured Money Fund

15.55%*

Minimum Deposit: \$2,500 Term: 4, 8 or 12 weeks

World's Secured Money Fund Certificates are fully secured by U.S. Government and Federal Agency bonds. Rates are set daily and guaranteed for the term of the certificate. No penalty is assessed for early withdrawal, although a \$10 processing fee will be charged. Since Money Fund Certificates are not savings accounts or deposits, these certificates are not insured by the Federal Savings and Loan Insurance Corporation.

*Advertised rate subject to change daily.

WORLD SAVINGS

AND LOAN ASSOCIATION

103 offices throughout California.

MEMBER \$5 BILLION GOLDEN WEST FINANCIAL CORPORATION

Wash. Post June 1, 1981

**Central National's MONEY MARKET FUND
OFFERS ...**



14.92%
Annual Percentage Rate

GUARANTEED!

**On Short Term,
Money Market Fund
Investments***

- Guaranteed interest *regardless* of market fluctuation
- Minimum investment — \$3,000
- 4 to 12 week terms

Retail Repurchase Agreement allows investors to withdraw their entire investment plus interest when agreement terminates *OR* renegotiate for subsequent 4 to 12 week terms.

 **Central National Bank** of Maryland

Hillendale • Hyattsville • Wheaton • Bethesda • Beltsville • Gaithersburg

439-4000

*The fund is secured by an interest in U.S. Government securities and represents a debt obligation of the bank and NOT a deposit agreement and is not covered by FDIC insurance.

OMAHA WORLD-HERALD, June 3, 1981

First Federal Lincoln offers... MoneyFund

14.061*

ANNUAL INTEREST RATE

15.004*

ANNUALIZED YIELD

MoneyFund gives you all these features:

- High interest on short term investment
- Interest earned daily—compounded monthly
- Funds available anytime without penalty
- No fees or service charges
- Overdraft option on checking
- renew entire investment to a higher rate

First Federal Lincoln is pleased to offer MoneyFund... a new short-term, high-yield investment opportunity for businesses and individuals.

The minimum investment is \$5,000 with a term of 89 days. And you can redeem all or part of your investment in \$500 minimums at any time with interest earned to date...so your investment plus interest is always available.

First Federal Lincoln assures that your investment is fully protected, and at maturity you will receive both your principal and the interest you've earned.

CALL FOR CURRENT RATES

Dial your access number, then

800/742-7600

We are pleased to offer you this toll free number to keep you informed of the changing Money Market Certificate rates as well as the new MoneyFund rates.

MoneyFund is a Repurchase Agreement fully secured by a U.S. Government or U.S. Government Agency Security. This obligation is not a savings account or deposit and is not insured by the Federal Savings and Loan Insurance Corporation.

**89
DAY
TERM**

If rates go up

You can take advantage of higher rates by making additional investments in minimums of \$500 or more to your MoneyFund. This assures you of a new 89 day term at the higher rate on your entire investment.

If rates go down

You are assured that you will earn at the rate of interest in effect at the time you made your investment.

Overdraft for checking

Your investment in MoneyFund can be used as an overdraft privilege on your MoneyNow checking account. Ask for more details.

Compare other plans and then stop in any First Federal Lincoln office and start your MoneyFund investment.

*Rate is in effect thru Monday. New MoneyFund rates are announced every Tuesday.



MoneyFund...
a good reason
to change where
you bank.

invest

Introducing The Banking Center's Guaranteed Investment Fund

A unique short-term investment opportunity, The Banking Center's Guaranteed Investment Fund (GIF) offers you **HIGH INTEREST** for a **SHORT-TERM** of **84 DAYS**.

GUARANTEED INVESTMENT FUND RATE
Minimum Investment: \$5,000
\$19 thru 5/25

14.25%
Annual Percentage Rate
For 84 Days

GIF is not a deposit or a savings account and is not insured by the FDIC. Based on a minimum investment of \$5,000, GIF represents a repurchase agreement between The Banking Center and the investor. This investment is secured by a U.S.

Government security. This offer may be modified or withdrawn by the Bank at any time without notice. Interest is not compounded and the agreement may not be terminated by the Purchaser prior to the Due Date.

The Banking Center's Guaranteed Investment Fund—for more information call the nearest office of The Banking Center NOW, or mail the coupon below—you have nothing to lose. Just a lot to gain—and we guarantee it!

YES! I would like more information on The Banking Center's Guaranteed Investment Fund!

Name

Address

City/State Zip

Phone Number

MAIL TO: THE BANKING CENTER, MARKETING SERVICE,
68 North Main Street, Westbury, CT 06581

The Banking Center also has available longer term, high yielding 6 month Money Market Certificates and 30 month Certificates of Deposit.

THIS WEEK'S RATE
60 MONTH SAVINGS CERTIFICATE
\$19 thru 5/25

15.275% | 16.090%

Annual Percentage Rate | Annual Effective Yield
Minimum Deposit: \$40,000

While federal regulations prohibit compounding of this high rate, at The Banking Center you earn even higher interest by agreeing to have your monthly interest compounded to a regular savings account—plus you'll receive it on your interest.

THIS WEEK'S RATE
30 MONTH CERTIFICATE OF DEPOSIT
\$12 thru 5/25

12.00% | 12.94%

Annual Percentage Rate | Annual Effective Yield
Minimum Deposit: \$500

At The Banking Center you earn 10% more interest than any comparable bank can pay and your interest will be compounded continuously from day of deposit and paid monthly.

*The annual effective yield is what your money will earn if your certificate and interest remain on deposit for an additional 36 months at the same rate. Premature withdrawals on all certificates will be paid with the current rate at a substantial interest penalty. All deposits insured by FDIC. 06/85.



The Banking Center

Offices serving Lower Fairfield County

DARLEN OFFICE
878 Post Road
655-8895

WESTPORT OFFICE
48 Post Road East
226-7449

WILTON OFFICE
221 Danbury Road (Rt. 7)
762-5518 **Member FDIC**

Guaranteed Investment Fund



Repurchase Agreement

SAMPLE

THE BANKING CENTER, in consideration of the Purchase Price listed below, which we state we have received, hereby sells to you,

(name of purchaser)

an interest in the following securities:

**A \$21,500,000 POOL OF
GOVERNMENT GUARANTEED SECURITIES
(Pool A)**

The amount of your interest in these securities is equal to the proportion which the purchase price bears to the total face value of these securities on the date of this Agreement.

On the business day following the "repurchase date", we will repurchase your interest in these securities from you for the "repurchase price" listed below.

You cannot assign or transfer all or any part of this Agreement or all or any part of your interest in these securities, to any person for any reason.

We have no obligation to repurchase your interest in these securities before the "repurchase date".

We will not send you any notice telling you that the "repurchase date" is about to occur.

NEITHER THIS AGREEMENT NOR YOUR INTEREST IN THESE SECURITIES IS A DEPOSIT. NEITHER THIS AGREEMENT NOR YOUR INTEREST IN THESE SECURITIES IS INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION.

This Agreement will have no further effect, and your interest in these securities will terminate, on the repurchase date.

This Agreement is governed by the terms of an Investment Fund Agreement.

Account Number	Repurchase Agreement Date	Repurchase Date	Purchase Price	APR
Number of Days	Investment Fund Agreement Date		Repurchase Price	

THE BANKING CENTER

Its Authorized Official



The Banking Center

Guaranteed Investment Fund



Investment Fund Agreement

SAMPLE

Account No. _____

Date of this Agreement _____

Sale of Interest In Securities

THE BANKING CENTER, has agreed to sell you, the person identified below as the "purchaser", an interest in securities. The securities in which you have an interest are listed on the agreement, called a "Repurchase Agreement", which is attached. The securities in which we have agreed to sell you an interest are currently owned by us as part of our investment assets.

What Happens on the "Repurchase Date"

On the business day following the date listed on the attached "Repurchase Agreement" as the "repurchase date", we will repurchase your interest in securities from you, unless, prior to that date, you have asked us to sell you another interest in securities and we have agreed to do so. You can ask us to sell you another interest in securities by coming to any of our offices, by mailing us your request, or by calling us on the telephone. We have no obligation to repurchase your interest in these securities before the "repurchase date".

What Happens When We Repurchase Your Interest—Non Interest Bearing Account

When we repurchase your interest in these securities, we will take the amount listed on the attached "Repurchase Agreement" as the "repurchase price" and place it in a non interest bearing account until you tell us what you want us to do with your money.

What Happens If We Sell You Another Interest In Securities

If we sell you another interest in securities, we will send you a new "Repurchase Agreement", stamp the "Repurchase Agreement" which is attached "canceled", and attach in its place a copy of your new "Repurchase Agreement". We will list on your new "Repurchase Agreement" the securities in which you have an interest, the date on which we will repurchase these securities, and the amount we will pay you as the "repurchase price".

What Happens If Entire Repurchase Price Is Not Used—Non Interest Bearing Account

If we cannot or do not use the entire "repurchase price" in selling you another interest in securities, we will take any part which remains and put it in a non interest bearing account until you tell us what you want us to do with your money.

Securities to be Held by Us

We will hold in safe-keeping the securities in which you have an interest until the "repurchase date". Neither this Agreement, nor any "Repurchase Agreement" which this Agreement governs, gives you a right to possess all or any of the securities in which you have an interest.

Interest In Securities Not Insured

NEITHER THIS AGREEMENT, NOR ANY "REPURCHASE AGREEMENT" WHICH THIS AGREEMENT GOVERNS, NOR YOUR INTEREST IN ANY SECURITIES, IS A DEPOSIT. NEITHER THIS AGREEMENT, NOR ANY "REPURCHASE AGREEMENT" WHICH THIS AGREEMENT GOVERNS, NOR YOUR INTEREST IN ANY SECURITIES, IS INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION.

You Cannot Transfer Repurchase Agreement or Interest In Securities

You cannot assign or transfer all or any part of any "Repurchase Agreement", or all or any part of your interest in any securities, to any person for any reason.

Repurchase Agreement and Interest In Securities Ends on Repurchase Date

Each "Repurchase Agreement" which this Agreement governs will have no further effect, and your interest in any securities listed on any such "Repurchase Agreement" will automatically end, on the "repurchase date".

THE BANKING CENTER

Its Authorized Official

Purchaser's Agreement

I have read this Agreement, I understand what it says and what it means. I agree to its terms.

PURCHASER

(city/town)

(state)



The Banking Center

TRIN-SETTER INVESTMENT FUND COMPETITIVE YIELDS NO WITHDRAWAL PENALTY NO SERVICE FEE!

Trinity Savings offers another Trin-Setting idea in money management. Our Trin-Setter Investment Fund earns interest based on a daily investment rate. Interest accrues on a daily basis equal to the base rate established by the Association. Accounts can be opened with a minimum deposit of \$1,000.00 and deposits or withdrawals can be made daily in \$500.00 increments during regular business hours. Balances below the \$1,000.00 minimum will earn interest at 5 1/4%.

The Trin-Setter Investment Fund is a high yield alternative to other investment options. Deposits and withdrawals can be made on a daily basis without penalty or a service fee. Trinity Savings invites you to visit one of our branches to open your Trin-Setter Investment Fund - a trend in money management.

INVESTED AMOUNT	ON MAY 26, 1981, YOU WOULD HAVE EARNED
\$1,000 - 99,999	15.375%
\$10,000 - \$100,000	16.875%
Over \$100,000	-CALL FOR CURRENT QUOTATION-



1200 Travis at Polk, Houston, Texas 77002 - (713)757-0797



Central National Begins Money Market Fund

By Lois Reed Manning
Washington Post Staff Writer

Investors with an idle or \$1,000 have a new way to earn competitive interest rates on their money while keeping it fairly liquid and low-risk.

Central National Bank, based in Silver Spring, starting today will operate CNE Money Market Fund, offering interest rates pegged one percentage point below money market certificate rates, President Tom Moore said. Initially, that means investors could earn 14.9 percent on deposits of as little as \$1,000 for terms as short as four weeks and as long as 13 weeks.

The new instrument, Moore said yesterday, actually is a third category of deposit — not a demand deposit (such as a checking account) or a savings deposit (which would earn much lower interest for the saver) — authorized May 13 by the Comptroller of the Currency.

U.S. Treasury and other agency obligations purchased by the bank will be set aside to secure the CNE fund, he said.

In effect, the customer lends money to the bank, which puts up the securities as collateral for the loan. At the end of whatever term the investor selects, the bank agrees to repurchase those securities and pay the customer 14.9 percent interest for use of the funds. There is an interest penalty for early withdrawal.

No matter who you are, borrowing money is expensive these days, and this applies to banks, as well. What the new fund does for Central is give it a larger pool of available funds at lower cost.

APPENDIX G

97th Congress
1st Session

S. _____

To foster competition and
provide for fair and effective
regulation of the financial industry

IN THE SENATE OF THE UNITED STATES

_____, 1981

_____ introduced the following bill; which was read
twice and referred to the Committee on Banking, Housing and
Urban Affairs.

A Bill

To foster competition and provide for fair and
effective regulation of the financial industry.

Be it enacted by the Senate and House of Representa-
tives in the United States of America in Congress assembled,

Sec. 1. That Section 3(a)(2) of the Securities Act of
1933 (15 U.S.C. §77c(a)(2)) is amended to read in its entirety:

"(2) Any security issued or guaranteed by
the United States or any territory thereof, or by

the District of Columbia, or by any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of one or more States or territories, or by any person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States; or any certificate of deposit for any of the foregoing; or any security which is an industrial development bond (as defined in section 103(c)(2) of the Internal Revenue Code of 1954) the interest on which is excludable from gross income under section 103(a)(1) of such Code if, by reason of the application of paragraph (4) or (6) of section 103(c) of such Code (determined as if paragraphs (4)(A), (5), and (7) were not included in such section 103(c), paragraph (1) of such section 103(c) does not apply to such security; or any interest or participation in a separate account maintained by an insurance company which interest or participation is issued in connection with (A) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of the Internal Revenue Code of 1954, or (B) an annuity plan which meets the requirements for the deduction of the employers'

contribution under section 404(a)(2) of such Code, other than any plan described in clause (A) or (B) of this paragraph (i) the contributions under which are held in a separate account maintained by an insurance company for a single employer and under which an amount in excess of the employer's contribution is allocated to the purchase of securities (other than interests or participations in the trust or separate account itself) issued by the employer or by any company directly or indirectly controlling, controlled by or under common control with the employer or (ii) which covers employees some or all of whom are employees within the meaning of section 401(c)(1) of such Code. The Commission, by rules and regulations or order, shall exempt from the provisions of section 5 of this title any interest or participation issued in connection with a stock bonus, pension, profit-sharing, or annuity plan which covers employees some or all of whom are employees within the meaning of section 401(c)(1) of the Internal Revenue Code of 1954, if and to the extent that the Commission determines this to be necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title."

Sec. 2. That section 3(a)(5) of the Securities Act of 1933 (15 U.S.C. §77c(a)(5)) is amended to read in its entirety:

"(5) Any security issued by (i) a farmer's cooperative organization exempt from tax under section 521 of the Internal Revenue Code of 1954, (ii) a corporation described in section 501(c)(16) of such Code and exempt from tax under section 501(a) of such Code, or (iii) a corporation described in section 501(c)(2) of such Code which is exempt from tax under section 501(a) of such Code and is organized from the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization or corporation described in clause (i) or (ii);"

Sec. 3. That Section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a)(4)) is amended by deleting the words: "but does not include a bank," following the words: "for the account of others."

Sec. 4. That Section 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a)(5)) is amended by deleting the words: "a bank", following the words: "but does not include."

Sec. 5. That Section 3(a)(12) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a)(12)) is amended by

deleting the words: "or a collective trust fund maintained by a bank" following the words "interest or participation in a single trust fund."

Sec. 6. That Section 3(a)(12) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a)(12)) is further amended by deleting the words: "any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian."

Sec. 7. That Section 12(g)(2) of the Securities Exchange Act of 1934 (15 U.S.C. §781(g)(2)) is amended by deleting Section 12(g)(2)(C) (15 U.S.C. §781(g)(2)(C)) in its entirety and renumbering subsections (D), (E), (F), (G) and (H) accordingly.

Sec. 8. That Section 12(g)(2)(G) of the Securities Exchange Act of 1934 (as renumbered) (15 U.S.C. §781(g)(2)(G)) is further amended by deleting the words: "in any collective trust funds maintained by a bank", after the words: "any interest or participation."

Sec. 9. That Section 12(i) of the Securities Exchange Act of 1934 (15 U.S.C. §781(i)) is deleted in its entirety, and that Sections 12(j), (k) and (l) are renumbered accordingly.

Sec. 10. That section 3(a)(3) of the Investment Company Act of 1940 (15 U.S.C. §80a-3(c)(3)) is amended by deleting the words: "any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian."

Sec. 11. That section 3(c)(11) of the Investment Company Act of 1940 (15 U.S.C. §80a-3(c)(11)) is amended by deleting the words: "or any collective trust fund maintained by a bank consisting solely of assets for such trusts;"

Sec. 12. That section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. §80b-2(a)(11)) is amended to read in its entirety:

"(11) 'Investment adviser' means any person including a bank, bank holding company, or a subsidiary thereof, savings and loan association, savings bank or a credit union, who, for compensation engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) any lawyer, accountant

engineer, or teacher whose performance of such services is solely incidental to the practice of his profession; (B) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore; (C) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; (D) any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to section 78c(a)(12) of this title, as exempted securities for the purposes of the Securities Exchange Act of 1934; or (E) such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order."

SUMMARY OF THE BILL

Today, banks engage in a myriad of commercial activities outside of the normal business of banking. In light of this expansion, it is appropriate to re-examine, and modify or eliminate, the existing exemptions for bank securities-related activities which were based on the assumption that banks would engage in more conservative activities and that depositors were fully protected by federal depository insurance.

The Bill would make available to investors in bank-sponsored investments and to customers of bank brokerage and investment advisory services the fundamental investor protections that are provided by the federal securities laws. This would be accomplished by amendments to the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act.

Common Trust Funds

Common trust funds were first recognized in the Revenue Act of 1936, and in 1937 the Federal Reserve Board adopted Section 17 of Regulation F authorizing national and state member banks to establish common trust funds. Section 17 expressly provided that the new authority could not be used to promote investment management services and stated that "the operation of such common trust funds as investment trusts for other than strictly fiduciary purposes is hereby prohibited."

Bank common trust funds have since become a multi-billion dollar industry. According to an American Bankers Association study, as of 1978, the assets of bank common trust funds equalled \$27 billion. Yet investors in bank common trust funds do not have the fundamental protections of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. Now, the banking industry is moving aggressively to use common trust funds as investment management vehicles to attract new capital from customers with whom the bank does not necessarily have pre-existing fiduciary relationships.

Nothing could better illustrate the dangers of leaving bank common trust funds outside the investor protection provisions of the federal securities laws, than the recent experience of the ICU Services Government Securities Program (ICU Fund). The ICU fund was established in 1968 as a common trust fund by its sponsors, the First Wisconsin National Bank of Milwaukee, and the ICU Services Corporation, an affiliate of a credit union trade organization. The fund is offered to more than 22,500 state and federal credit unions in the United States, and is subject to the jurisdiction of the Comptroller of the Currency, not the Securities and Exchange Commission ("SEC"), although it files certain reports with the SEC.

A review of the summary reports filed by the Fund with the SEC reveal arrangements for compensation of fund management, serious conflict of interest situations, and methods of portfolio valuation, that would not have been permitted had the Fund been subject to the Investment Company Act.

The consequences of the inapplicability of the Investment Company Act to the ICU Fund have now become apparent. The following account was carried in the October 12, 1981, issue of the CUIS Newsletter, an independent newsletter for credit unions:

Account balances in ICU Services Corp's Government Securities Program (GSP) have declined from almost \$3 billion last year to \$736 million at the end of September. With the GSP's yield at 13.08% for September -- 300-400 basis points below comparable investments -- questions about its financial stability have arisen. In the unlikely event that all CUs asked for their money tomorrow, the GSP could not pay 100 cents on the dollar, according to ICU statistics. Nearly half the nation's CUs have funds in the GSP.

The GSP is "technically insolvent," says one analyst. Account balances at the end of August totalled \$758 million, while the total market value of the GSP's assets (cash plus investments) totalled only \$708 million. For perspective, the same would be true of many S&Ls if the S&Ls marked down their assets to market value, as ICU does, note observers. ICU reportedly has hundreds of millions of dollars in cash and equivalents to meet its obligations.

Even so, it's unclear where the GSP would get enough money to pay off all investors, in the unlikely event of a "run." Under ICU rules, any CU can demand -- and get -- its entire investment an any time, even if the fund has suffered losses in the interim. The same is not true of mutual

funds, or even NIFCU\$, NAFCU's common-trust fund. The NIFCU\$ short-term fund distributes its market losses to investors. The GSP aggregates them into a "deferred market losses" account, then subtracts an amortized portion of the losses from each investing CU's earnings every month.

In addition to this example, studies indicate that other abuses exist where bank common trust funds purchase significant amounts of securities issued by important commercial customers of the bank despite the fact that such investments may not be the best available investments for the beneficiaries of a bank's trust services. Common trust funds also may be used as "dumping grounds" for undesirable securities issued by commercial customers of the bank. Conflicts have also been shown to arise when the trust department obtains and acts upon confidential information from the bank's commercial department concerning a commercial customer.

Collective Funds for Retirement Plans

Bank collective funds for retirement plans have their genesis in the common trust funds first authorized by the Federal Reserve Board in 1937. Since the Board consistently prohibited advertising and merchandising of these funds, they were exempted from registration under the federal securities laws. In 1955, the Board revised its regulations to permit banks to establish collective funds as an investment vehicle for retirement plans. Then, in 1962, Congress shifted regulatory authority over national and member bank trust

funds from the Federal Reserve Board to the Comptroller of the Currency.

In 1970, Congress exempted bank collective funds for retirement plans from the Securities Act. This exemption, corresponding to the existing exemption for common trust funds, made sense for the same reason as the common trust fund exemption; regulations of the Comptroller of the Currency prohibited advertising and merchandising of bank collective funds.

Shortly after enactment of the 1970 exemption, however, the Comptroller amended his regulations, without explanation, to permit banks to advertise and publicize their collective investment funds for retirement plans. This regulatory change set the stage for increasingly aggressive bank advertising campaigns to merchandise collective investment funds for retirement plans.

Today, banking institutions across the country manage funds with assets in excess of \$50 billion, in the aggregate, and actively promote and merchandise interests in these funds, not only to hundreds of thousands of corporate retirement plans, but also to millions of individuals who rely on bank collective funds for retirement plans for financial security in their retirement years. A brief review of how banking institutions conduct these activities demonstrates why application of the federal securities laws is appropriate.

Bank promotional material is laden with extravagant promises of investment performance. In many cases, banks' claims to be "Number 1" can be justified only because they carefully selected the time period used to measure their fund's performance. In addition, not only have different banks carefully selected different time periods for measuring their performance records, some banks change this period whenever convenient. Banks have also touted their investment performance by selecting different market indices which best reflect their claims. At the same time, banking institution advertising and promotional materials generally fail to provide fundamental information such as the extent of a fund's investment discretion, advisory fees, per share income and capital, valuation dates, payment of distributions, investment of portfolio cash, purchases of certificates of deposit issued by affiliates of the fund, allocation of brokerage commissions and reports to participants.

The enormous size of bank collective funds for retirement plans also presents many opportunities for conflicts of interest. Unfortunately, available information indicates that the potential hazards arising from conflicts between banks' fund management activities and their customary commercial banking operations have reached the point where they are matters of serious concern. For example, studies indicate that there is a linkage between banks' commercial loan

customers and the companies for which the banks administer pension fund assets. Banking institutions may make loans to companies whose stock they purchase for collective funds and may, therefore, have an interest in "propping up" the company by buying or holding its stock when it would otherwise be prudent to sell.

Banks also reportedly exert pressures on prospective loan customers to bring their pension business to the bank to manage. This problem was noted in an editorial in Pensions & Investments, a bi-weekly newspaper published for members of the pension business, including bank pension managers. The editorial noted that "a glance at the roster of managers maintained by some of the [pension plan] sponsors immediately arouses suspicion. . . ." The editorial then asked how it can be that the list of pension plan managers is "composed almost entirely of banks, most of which have languished near the bottom of the investment performance tables for almost a decade?" In view of the poor performance of bank managers of pension funds, "[m]any observers suspect that some large banks have maintained their pension clients over the past eight or nine years mainly because they have commercial ties with those clients." The editorial pointed out that "clients fear corporate relations will be jeopardized if they fire the banks as pension fund managers."

Another good example of this conflict is evidenced in the situation, described to the Wall Street Journal by a

former Continental Illinois National Bank employee, where the commercial lending officer tells the potential corporate customer how their full service bank would "love" to manage his pension fund, and "[t]he executives get the picture pretty quickly."

Banking institution conflicts may also arise in the context of contests for corporate control, where a bank's collective fund owns sufficient shares of a company to be a significant factor in a takeover bid. A recent example of this occurred in connection with the battle of Conoco, Inc. among DuPont, Seagram and Mobil. Bankers Trust was the single largest shareholder of Conoco and was also the largest shareholder of Mobil -- the very company whose acquisition overtures Conoco management was vigorously resisting. Bankers Trust also managed the employee stock plans of Conoco, Mobil and DuPont. Thus, Bankers Trust would vote on behalf of the employee shareholders on all sides of the takeover transaction.

Other conflicts of interest in bank management of collective investment funds for retirement plans stem from the temptation to maximize the amount of idle cash in collective funds by increasing the "float" available for use by a bank's other activities. This may be accomplished by establishing infrequent valuation dates for investment of cash received, and by permitting amounts to remain uninvested in non-interest

bearing accounts in the interim. Bank collective funds may also be caused to invest in certificates of deposit issued by the sponsoring bank. This is particularly troublesome where other investments are paying a more attractive return.

Retail Repurchase Agreements

Many securities issued by banks today bear little resemblance to banks' traditional deposits. A recent example, are the retail repurchase agreements ("retail repos"), which are, in economic reality, uninsured debt obligations of the issuing financial institution. They are not deposits, and thus are not covered by federal insurance programs; in addition, they are not subject to full SEC disclosure requirements.

Consequently, the manner in which retail repos are marketed to the public raises serious concerns, and the spectre of injury to investors. The complex nature of retail repos has led to confusion in the minds of investors, since they are often marketed in a way that makes them appear to be simple, insured deposits, which they are not. Customers are often not adequately advised that they may become unsecured creditors of shaky depository institutions, to the full extent that the market value of their security interest should fall below the amount of the funds invested.

Repos are marketed in spite of other serious disclosure deficiencies. Among other things, retail repos have been promoted by means of advertisements which do not provide

appropriate disclosure of the bank's financial condition, the nature and terms of the agreement (including minimum investment denominations, interest rates, maturities and any prepayment fees), and the nature of the security underlying the investment.

Retail repos have been merchandised in ways that imply that the investor is either making a deposit with a bank or obtaining an interest in a government security, not in a debt security issued by the bank. For example, advertisements use terms such as "Guarantee," "Guaranteed," "Guaranteed Return" or "Guaranteed Interest." Banking promotional literature blithely states that the agreements are secured by the "U.S. Government" or "U.S. Government agency securities." Finally, while the bank regulators require the issuing institution to describe its retail repo agreements as one to repurchase for a "fixed amount," the offering materials and advertisements have often promised a return expressed in terms of interest rates, based on either daily or weekly computations.

Similarly, virtually all the advertisements use the terms "Money Market Fund," "Money Fund" or "Fund." Moreover, several of the institutions have selected names for their retail repos offerings that bear a close resemblance to the names of money market mutual funds already registered with the SEC under the Investment Company Act of 1940.

This has naturally led to investor misapprehension, so much so that the Washington Post was misled into reporting that the Central National Bank of Silver Spring was operating a "money market fund." Furthermore, institutions which offer retail repos have ignored the regulators' demands that the absence of federal insurance be clearly shown in bold type.

While retail repos are the clearest example of the need for greater investor protection, they are by no means the only example. Accordingly, the proposed Bill would remove the current exemptions for bank securities, putting banks on an equal footing with other companies. To the extent that it is inappropriate to subject banks to any specific provisions of the securities laws, the SEC has ample power, under existing law, to modify the normal requirements in any way "necessary or appropriate in the public interest or for the protection of investors," and should make appropriate use of such authority.

* * * *

While the banking regulatory agencies have attempted to address some of these abuses, the banking regulatory scheme is designed to promote the fiscal integrity of banking institutions, not to protect the interests of investors in bank-sponsored investments. Moreover, to the limited extent that

banking regulators regulate bank investment products, different agencies, including the Federal Reserve Board and the Comptroller of the Currency have applied differing rules, with differing expertise, and different degrees of enforcement vigor.

Regulation of bank common trust funds, collective funds for retirement plans and retail repos would provide investors with meaningful prophylactic protections against the abuses described above. As Stephen J. Friedman, then-SEC Commissioner, declared in November, 1980:

If banks are managing an entity that is the functional equivalent of a mutual fund or a closed-end investment company, there is no reason to have different rules regarding self-dealing, pricing, approval of investment management fees, and the like. The need for independent directors is as great as in a mutual fund complex.

Advisory Services

Recent years have seen a dramatic increase in the types of investment advisory services offered by banking institutions as well as a significant increase in the amount of assets managed by these firms. Published reports of bank regulatory agencies indicate that trust assets of banks and trust companies grew from \$288.5 billion in 1970 to \$502.7 billion in 1977. As of 1980, these assets are estimated to total \$600 billion. Contrasted to this, registered investment advisers managed an estimated \$200 billion in assets.

While some percentage of this expansion may be traceable to bank management of bona fide trusts, a significant portion of the growth has also taken place in the area of non-trust assets managed by banking institutions, which those institutions merchandise to the general public. For example, banking institutions currently sponsor or advise at least sixteen registered investment companies. Banks have also begun to aggressively merchandise interests in their collective pension funds. As reported in the Securities and Exchange Commission's 1977 Final Report on Bank Securities Activities, at the end of 1975, the top 115 banks operated 465 collective pension funds with assets of \$21.5 billion. According to a survey by the American Bankers Association, three years later, at the end of 1978, there were 1,330 collective funds for retirement plans holding assets of \$47.5 billion.

Coupled with this increase in the number and types of collective investment funds, and the amount of assets under management, banking institutions have also increased their investment advisory activities with respect to individual accounts. At the end of 1970, commercial banks advised managing agency accounts with total assets of \$61.9 billion. At the same time, banking institutions have increased their marketing efforts aimed at attracting individual advisory account customers. Banking journals frequently contain

advertising material exhorting bankers on marketing their advisory services to individuals.

Despite the extent of the investment advisory activity conducted by banking institutions, and the magnitude of the assets subject to their total or partial investment discretion, banks and bank holding companies are exempt from registration and regulation under the Investment Advisers Act. This may have been sensible in 1940 when the Act was passed, since, at that time, the investment advisory activities of banking institutions were generally confined to traditional trust activities. Today, such a blanket exemption makes no sense. Former SEC Chairman Williams well summarized the situation during testimony given in 1979, when he said:

"It would be anomalous if all financial institutions offering investment advice to the general public, whether directly or through publicly-solicited individual advisory relationships or indirectly through publicly-solicited collective investment management arrangements like investment companies, were not subject to the same regulatory requirements, the same fiduciary responsibilities and the same degree of enforcement presence."

State and federal banking laws simply do not provide investor protection comparable to that afforded under the Investment Advisers Act. Banking laws are designed to promote fiscal integrity of banking institutions, not to protect investors. For example, the banking laws and regulations do not contain safeguards that match the registration and licensing requirements of the Investment Advisers

Act, or that impose comparable ongoing obligations with respect to the content and accuracy of advertising, advisory contracts with customers, methods of calculating fees and promotional brochure disclosures. Moreover, banking activities today are regulated by a frequently baffling array of banking agencies: the Federal Reserve Board, Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board and National Credit Union Administration Board, which apply different regulations, with varying degrees of expertise and enforcement vigor.

Summary

The Bill would safeguard investors and customers of current securities-related activities by applying the federal securities laws to those activities. This step would provide investors in bank investment products, clients of bank investment advisory services and customers of bank brokers and dealers with the same investment protections against conflicts of interest and the same type of disclosure of the same type of meaningful information, as are enjoyed by investors, clients and customers of non-bank investment products and services.

The CHAIRMAN. I would appreciate it if you can hold your statements to 10 minutes.

Mr. Silver was not much over, and I did not warn him. But I will drop the gavel on the rest of you now, being forewarned. If we could keep your statements to 10 minutes, I would appreciate it very much.

Mr. Cantor?

Mr. CANTOR. Mr. Chairman, my name is Samuel C. Cantor. I am the executive vice president of the Mutual Life Insurance Co. of New York. I appear here today on behalf of the American Council of Life Insurance.

I am accompanied by Mr. Gary Hughes, on my left, chief counsel, securities of the American Council.

The council has a membership of 525 life insurance companies that represent 97 percent of the total assets of all U.S. life insurance companies and U.S. branches of Canadian companies. We appreciate the opportunity you have extended us to comment on S. 1720.

We have submitted a more detailed statement in writing, and I will just very briefly summarize for you today the nature of that statement.

I might say at the outset, Senator, that I read with interest the comments you made at the time of introducing the bill, particularly those that dealt with the need to consider comprehensive legislation to cope with the problems faced by banking institutions in today's economy. I could not help observing that, were we to substitute life insurance companies for banks, the statement would be equally applicable.

Therefore, we approach this hearing with complete understanding and sympathy as to the need to solve the problems to which this bill addresses itself.

We are concerned, in a broad sense, with certain legal, economic, and policy implications inherent in S. 1720. Our concern relates specifically to section 302, which would permit commercial banks and other thrift institutions to organize, operate, and render investment advice to investment companies, and to underwrite, sell, or issue their shares. This activity would, to a major degree, abrogate the clearly defined lines between commercial and investment banking which was established by the Glass-Steagall Act.

We are not taking any position at the present moment on the propriety of ultimately permitting banking institutions to enter the mutual fund business. We are, however, conscious of the fact that Glass-Steagall's separation of investment and commercial banking was predicated upon very real congressional concerns regarding various abuses in the banking system during the 1920's and the 1930's.

We recognize that since that time financial institutions and the economic and regulatory environment in which they operate have changed considerably. However, we feel that the fundamental question still remains as to whether these changes have obviated or overridden the policy considerations underlying the Glass-Steagall Act.

REASSESSMENT OF GLASS-STEAGALL ACT

I note that in his testimony the other day, Treasury Secretary Regan pointed out that the potential for conflicts of interest and unfair competition existed if banks, as opposed to bank holding companies, engaged in the mutual fund business. We note also that you have indicated that a broad reassessment of the Glass-Steagall Act will be shortly undertaken.

We feel very strongly that that reassessment, that indepth study of the Glass-Steagall Act and its present applicability, certainly ought to come before we precipitously abrogate the Glass-Steagall Act restrictions.

At the same time, we feel that there should also be a broad review of the impact that such revisions would have on the broad economic aspects of the situation, particularly with respect to various financial institutions and the economy, and the consumer in general.

Now, as I have indicated, section 302 of S. 1720, which is the one part of this bill in which we are most interested, would permit banking institutions to underwrite mutual funds without complying with regulation under the Securities Exchange Act of 1934. The existing exemption of banks from the broker-dealer requirements of the 1934 act, and the exemption that the bill would add with respect to other thrift institutions must be read in the context of the provisions and policies of Glass-Steagall and its prohibition on investment banking or broker-dealer activities.

If we are to permit the business of underwriting by commercial banks, then certainly it would seem that there is need for appropriate SEC regulation of those activities. The 1934 act, of course, is in place. The SEC is already experienced with the regulation of broker-dealer activity. We see absolutely no way in which the public interest would be served by empowering bank regulatory bodies to develop and administer similar regulations, rather than utilizing the expertise and the existing facilities of the SEC.

I say this first from the standpoint of the protection of the public, which the securities laws were meant to provide; and second because of the potential for unequal and possibly conflicting regulation, which gives rise to the risk of unfair competition between the banks and others dealing in the securities field.

I think it is interesting to note that when life insurance companies became involved in the sale of mutual funds, and when variable annuities and variable life insurance were determined to be registerable securities, life insurance companies—despite the fact that they were, as are the banks, regulated by their own regulatory agencies—nevertheless were required to and have—registered under and have complied with the Federal securities laws.

It is respectfully suggested that, should it be determined after an appropriate study that the Glass-Steagall Act delineations between commercial and investment banking should be abrogated, bank participation in the mutual fund business be permitted only on the same terms and under the same regulations as are other institutions participating in the same business.

Thank you, sir.

[Complete statement follows:]

STATEMENT OF THE
AMERICAN COUNCIL OF LIFE INSURANCE

Mr. Chairman and members of the Committee. My name is Samuel C. Cantor, Executive Vice President of the Mutual Life Insurance Company of New York, and I am appearing on behalf of the American Council of Life Insurance. I am accompanied by Gary E. Hughes, Chief Counsel, Securities of the American Council of Life Insurance. The Council has a membership of 525 life insurance companies that represents 97% of the total assets of all United States life insurance companies and U.S. branches of Canadian companies. We appreciate the opportunity you have extended to us to comment on S.1720.

S.1720, entitled the "Financial Institutions Restructuring and Services Act of 1981", is a sweeping bill which addresses numerous competitive, economic and regulatory issues that are of great concern not only to the banking industry but also to the financial community generally. •

The Council's particular concern with S.1720 involves Section 302, which would enable banking institutions to organize and operate or render investment advice to investment companies. Section 302 would also permit banking entities to underwrite, sell or issue securities of any investment company. If enacted, this provision would expand significantly the financial activities in which banking institutions can engage and, in so doing, would abrogate in large part the delineation between investment and commercial banking which Congress so carefully established in 1933 with the passage of the Glass-Steagall Act. In addition, enactment of Section 302 as presently drafted would give rise to a disparate regulatory system as between investment companies

Statement made by:

Samuel C. Cantor
Executive Vice President
Mutual Life Insurance Company
of New York
1740 Broadway at 55th Street
New York, New York 10019

underwritten by banking institutions and those underwritten by all other entities. The Council wishes to express its concern regarding the propriety of altering the provisions of the Glass-Steagall Act at this time and register its opposition to the unequal regulatory treatment of investment companies embraced by Section 302.

Broad Considerations

Economic Concerns

S.1720 involves many complex and potentially far reaching concerns for financial institutions and the economy generally. In introducing the bill, Senator Garn spoke of the need to consider comprehensive legislation as a result of steadily increasing competition within the financial services industry. Citing inflation and high interest rates of recent years as factors causing financial institutions and consumers to adjust traditional practices and philosophies, Senator Garn concluded that revisions must be made in the structure of the financial system to accommodate the numerous changes that have occurred.

We agree that the economy and the financial services industry are undergoing a metamorphosis that is unprecedented in scope and significance. The life insurance industry is acutely aware of this rapidly changing environment and the accompanying pressure to adapt quickly in order to provide products and services of the highest utility to consumers.

We believe, however, that there has been little attention focused on the nature and extent of the economic impact that

enactment of S.1720 would have on the banking institutions to which it is directed, competing financial institutions and consumers. Given the present state of the economy, it is a most inopportune time for hasty legislation that would undoubtedly have a dramatic effect on this country's financial system. The importance of the issues involved demands that S.1720 be studied in much greater detail. In this way, legislation can be crafted in a deliberate fashion to address the complexities of today's institutions, and, given additional time, this process can be carried out taking full cognizance of the interrelated environment in which these institutions exist.

Glass-Steagall Concerns

At the outset, we wish to make clear that we are not taking a position on the propriety of ultimately restructuring the Glass-Steagall Act. Rather, we are voicing our concern that far too little study has been devoted to the extremely significant consequences that would flow from such action.

The Glass-Steagall Act was enacted at a time when the banking industry was undergoing severe economic stress and in fact was on the brink of collapse. In order to return banking institutions to financial stability, Congress passed a variety of significant legislation pertaining to the banking industry, including the Glass-Steagall Act. Principal among the effects of Glass-Steagall was the separation of commercial and investment banking functions. In legislating the dichotomy between commercial and investment banking activities, Congress sought

bearing accounts in the interim. Bank collective funds may also be caused to invest in certificates of deposit issued by the sponsoring bank. This is particularly troublesome where other investments are paying a more attractive return.

Retail Repurchase Agreements

Many securities issued by banks today bear little resemblance to banks' traditional deposits. A recent example, are the retail repurchase agreements ("retail repos"), which are, in economic reality, uninsured debt obligations of the issuing financial institution. They are not deposits, and thus are not covered by federal insurance programs; in addition, they are not subject to full SEC disclosure requirements.

Consequently, the manner in which retail repos are marketed to the public raises serious concerns, and the spectre of injury to investors. The complex nature of retail repos has led to confusion in the minds of investors, since they are often marketed in a way that makes them appear to be simple, insured deposits, which they are not. Customers are often not adequately advised that they may become unsecured creditors of shaky depository institutions, to the full extent that the market value of their security interest should fall below the amount of the funds invested.

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While retail repos are the clearest example of the need for greater investor protection, they are by no means the only example. Accordingly, the proposed Bill would remove the current exemptions for bank securities, putting banks on an equal footing with other companies. To the extent that it is inappropriate to subject banks to any specific provisions of the securities laws, the SEC has ample power, under existing law, to modify the normal requirements in any way "necessary or appropriate in the public interest or for the protection of investors," and should make appropriate use of such authority.

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While the banking regulatory agencies have attempted to address some of these abuses, the banking regulatory scheme is designed to promote the fiscal integrity of banking institutions, not to protect the interests of investors in bank-sponsored investments. Moreover, to the limited extent that

banking regulators regulate bank investment products, different agencies, including the Federal Reserve Board and the Comptroller of the Currency have applied differing rules, with differing expertise, and different degrees of enforcement vigor.

Regulation of bank common trust funds, collective funds for retirement plans and retail repos would provide investors with meaningful prophylactic protections against the abuses described above. As Stephen J. Friedman, then-SEC Commissioner, declared in November, 1980:

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While some percentage of this expansion may be traceable to bank management of bona fide trusts, a significant portion of the growth has also taken place in the area of non-trust assets managed by banking institutions, which those institutions merchandise to the general public. For example, banking institutions currently sponsor or advise at least sixteen registered investment companies. Banks have also begun to aggressively merchandise interests in their collective pension funds. As reported in the Securities and Exchange Commission's 1977 Final Report on Bank Securities Activities, at the end of 1975, the top 115 banks operated 465 collective pension funds with assets of \$21.5 billion. According to a survey by the American Bankers Association, three years later, at the end of 1978, there were 1,330 collective funds for retirement plans holding assets of \$47.5 billion.

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Despite the extent of the investment advisory activity conducted by banking institutions, and the magnitude of the assets subject to their total or partial investment discretion, banks and bank holding companies are exempt from registration and regulation under the Investment Advisers Act. This may have been sensible in 1940 when the Act was passed, since, at that time, the investment advisory activities of banking institutions were generally confined to traditional trust activities. Today, such a blanket exemption makes no sense. Former SEC Chairman Williams well summarized the situation during testimony given in 1979, when he said:

"It would be anomalous if all financial institutions offering investment advice to the general public, whether directly or through publicly-solicited individual advisory relationships or indirectly through publicly-solicited collective investment management arrangements like investment companies, were not subject to the same regulatory requirements, the same fiduciary responsibilities and the same degree of enforcement presence."

State and federal banking laws simply do not provide investor protection comparable to that afforded under the Investment Advisers Act. Banking laws are designed to promote fiscal integrity of banking institutions, not to protect investors. For example, the banking laws and regulations do not contain safeguards that match the registration and licensing requirements of the Investment Advisers

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Summary

The Bill would safeguard investors and customers of current securities-related activities by applying the federal securities laws to those activities. This step would provide investors in bank investment products, clients of bank investment advisory services and customers of bank brokers and dealers with the same investment protections against conflicts of interest and the same type of disclosure of the same type of meaningful information, as are enjoyed by investors, clients and customers of non-bank investment products and services.

The CHAIRMAN. I would appreciate it if you can hold your statements to 10 minutes.

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Mr. Cantor?

Mr. CANTOR. Mr. Chairman, my name is Samuel C. Cantor. I am the executive vice president of the Mutual Life Insurance Co. of New York. I appear here today on behalf of the American Council of Life Insurance.

I am accompanied by Mr. Gary Hughes, on my left, chief counsel, securities of the American Council.

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Therefore, we approach this hearing with complete understanding and sympathy as to the need to solve the problems to which this bill addresses itself.

We are concerned, in a broad sense, with certain legal, economic, and policy implications inherent in S. 1720. Our concern relates specifically to section 302, which would permit commercial banks and other thrift institutions to organize, operate, and render investment advice to investment companies, and to underwrite, sell, or issue their shares. This activity would, to a major degree, abrogate the clearly defined lines between commercial and investment banking which was established by the Glass-Steagall Act.

We are not taking any position at the present moment on the propriety of ultimately permitting banking institutions to enter the mutual fund business. We are, however, conscious of the fact that Glass-Steagall's separation of investment and commercial banking was predicated upon very real congressional concerns regarding various abuses in the banking system during the 1920's and the 1930's.

We recognize that since that time financial institutions and the economic and regulatory environment in which they operate have changed considerably. However, we feel that the fundamental question still remains as to whether these changes have obviated or overridden the policy considerations underlying the Glass-Steagall Act.

REASSESSMENT OF GLASS-STEAGALL ACT

I note that in his testimony the other day, Treasury Secretary Regan pointed out that the potential for conflicts of interest and unfair competition existed if banks, as opposed to bank holding companies, engaged in the mutual fund business. We note also that you have indicated that a broad reassessment of the Glass-Steagall Act will be shortly undertaken.

We feel very strongly that that reassessment, that indepth study of the Glass-Steagall Act and its present applicability, certainly ought to come before we precipitously abrogate the Glass-Steagall Act restrictions.

At the same time, we feel that there should also be a broad review of the impact that such revisions would have on the broad economic aspects of the situation, particularly with respect to various financial institutions and the economy, and the consumer in general.

Now, as I have indicated, section 302 of S. 1720, which is the one part of this bill in which we are most interested, would permit banking institutions to underwrite mutual funds without complying with regulation under the Securities Exchange Act of 1934. The existing exemption of banks from the broker-dealer requirements of the 1934 act, and the exemption that the bill would add with respect to other thrift institutions must be read in the context of the provisions and policies of Glass-Steagall and its prohibition on investment banking or broker-dealer activities.

If we are to permit the business of underwriting by commercial banks, then certainly it would seem that there is need for appropriate SEC regulation of those activities. The 1934 act, of course, is in place. The SEC is already experienced with the regulation of broker-dealer activity. We see absolutely no way in which the public interest would be served by empowering bank regulatory bodies to develop and administer similar regulations, rather than utilizing the expertise and the existing facilities of the SEC.

I say this first from the standpoint of the protection of the public, which the securities laws were meant to provide; and second because of the potential for unequal and possibly conflicting regulation, which gives rise to the risk of unfair competition between the banks and others dealing in the securities field.

I think it is interesting to note that when life insurance companies became involved in the sale of mutual funds, and when variable annuities and variable life insurance were determined to be registerable securities, life insurance companies—despite the fact that they were, as are the banks, regulated by their own regulatory agencies—nevertheless were required to and have—registered under and have complied with the Federal securities laws.

It is respectfully suggested that, should it be determined after an appropriate study that the Glass-Steagall Act delineations between commercial and investment banking should be abrogated, bank participation in the mutual fund business be permitted only on the same terms and under the same regulations as are other institutions participating in the same business.

Thank you, sir.

[Complete statement follows:]

STATEMENT OF THE
AMERICAN COUNCIL OF LIFE INSURANCE

Mr. Chairman and members of the Committee. My name is Samuel C. Cantor, Executive Vice President of the Mutual Life Insurance Company of New York, and I am appearing on behalf of the American Council of Life Insurance. I am accompanied by Gary E. Hughes, Chief Counsel, Securities of the American Council of Life Insurance. The Council has a membership of 525 life insurance companies that represents 97% of the total assets of all United States life insurance companies and U.S. branches of Canadian companies. We appreciate the opportunity you have extended to us to comment on S.1720.

S.1720, entitled the "Financial Institutions Restructuring and Services Act of 1981", is a sweeping bill which addresses numerous competitive, economic and regulatory issues that are of great concern not only to the banking industry but also to the financial community generally. *

The Council's particular concern with S.1720 involves Section 302, which would enable banking institutions to organize and operate or render investment advice to investment companies. Section 302 would also permit banking entities to underwrite, sell or issue securities of any investment company. If enacted, this provision would expand significantly the financial activities in which banking institutions can engage and, in so doing, would abrogate in large part the delineation between investment and commercial banking which Congress so carefully established in 1933 with the passage of the Glass-Steagall Act. In addition, enactment of Section 302 as presently drafted would give rise to a disparate regulatory system as between investment companies

Statement made by:

Samuel C. Cantor
Executive Vice President
Mutual Life Insurance Company
of New York
1740 Broadway at 55th Street
New York, New York 10019

underwritten by banking institutions and those underwritten by all other entities. The Council wishes to express its concern regarding the propriety of altering the provisions of the Glass-Steagall Act at this time and register its opposition to the unequal regulatory treatment of investment companies embraced by Section 302.

Broad Considerations

Economic Concerns

S.1720 involves many complex and potentially far reaching concerns for financial institutions and the economy generally. In introducing the bill, Senator Garn spoke of the need to consider comprehensive legislation as a result of steadily increasing competition within the financial services industry. Citing inflation and high interest rates of recent years as factors causing financial institutions and consumers to adjust traditional practices and philosophies, Senator Garn concluded that revisions must be made in the structure of the financial system to accommodate the numerous changes that have occurred.

We agree that the economy and the financial services industry are undergoing a metamorphosis that is unprecedented in scope and significance. The life insurance industry is acutely aware of this rapidly changing environment and the accompanying pressure to adapt quickly in order to provide products and services of the highest utility to consumers.

We believe, however, that there has been little attention focused on the nature and extent of the economic impact that

enactment of S.1720 would have on the banking institutions to which it is directed, competing financial institutions and consumers. Given the present state of the economy, it is a most inopportune time for hasty legislation that would undoubtedly have a dramatic effect on this country's financial system. The importance of the issues involved demands that S.1720 be studied in much greater detail. In this way, legislation can be crafted in a deliberate fashion to address the complexities of today's institutions, and, given additional time, this process can be carried out taking full cognizance of the interrelated environment in which these institutions exist.

Glass-Steagall Concerns

At the outset, we wish to make clear that we are not taking a position on the propriety of ultimately restructuring the Glass-Steagall Act. Rather, we are voicing our concern that far too little study has been devoted to the extremely significant consequences that would flow from such action.

The Glass-Steagall Act was enacted at a time when the banking industry was undergoing severe economic stress and in fact was on the brink of collapse. In order to return banking institutions to financial stability, Congress passed a variety of significant legislation pertaining to the banking industry, including the Glass-Steagall Act. Principal among the effects of Glass-Steagall was the separation of commercial and investment banking functions. In legislating the dichotomy between commercial and investment banking activities, Congress sought

to reestablish and promote confidence in the nation's banking system. The concerns which prompted this separation were several.

Prior to Glass-Steagall, national banks engaged in the investment securities business pursuant to their incidental corporate powers to engage in the banking business. In addition, many commercial banks established securities affiliates which operated as wholesalers and retailers of debt and equity securities, as holding and finance companies, as real estate and investment companies, and as market makers in the parent bank's own stock. Speculative excess and other unsound practices by banks in connection with these activities contributed to the bank failures of the Depression, and abuses by banks of their responsibilities to customers resulted in financial failures for many individuals.

One of the primary purposes of the Glass-Steagall Act was to eliminate the potential for conflicts of interest that could arise when a bank was in a position to give advice to customers regarding securities which the bank issued or had underwritten. The Act also sought to protect and maintain the financial integrity of banks by precluding the acquisition of securities which could jeopardize the liquidity of the banks or introduce speculative pressures upon them. In sum, the Act addressed very real abuses which occurred in the banking system during the late 1920s and early 1930s, and was passed by Congress following exhaustive analysis and testimony.

Section 302 of S.1720, as well as Section 301 dealing with the underwriting of municipal revenue bonds, clearly contradicts the legislative intent of Glass-Steagall and would conflict directly with those provisions of the Act which sought to delimit the securities activities of commercial banks. Indeed, these provisions would once again meld investment and commercial banking functions. Neither the bill nor its accompanying comments offers an explanation of, or a justification for, the proposed abrogation of the long-standing purposes and provisions of Glass-Steagall.

The circumstances that the Glass-Steagall Act addressed were of profound concern to Congress at the time of its enactment. Since that time, there is no question that financial institutions and the economic and regulatory environment in which they exist have undergone dramatic evolutionary changes. The fundamental question, however, is whether these changes obviate or override the policy considerations underlying Glass-Steagall or otherwise warrant the involvement of banking institutions in the securities business. Simply put, this question has not been answered satisfactorily, and we submit that it must be resolved before Congress takes any action on Glass-Steagall, not after. We believe that piecemeal changes to Glass-Steagall would be precipitate, absent a thorough analysis of the Act, its policies and the consequences of altering its prohibitions.

We note that in introducing S.1720, Senator Garn stated that a broad review of Glass-Steagall would be conducted in

1982. We submit that it would be highly inappropriate for Congress to enact Sections 301 and 302 of S.1720, thereby materially altering the provisions of Glass-Steagall, prior to conducting the broad review referred to by Senator Garn. This broad review would enable Congress to consider these and other important provisions of S.1720 in an integrated manner and would afford interested parties sufficient time to develop and contribute valuable and necessary input.

Regulatory Parity

Should Congress ultimately determine that it is appropriate to permit banking institutions to engage in the organization, operation and distribution of mutual funds, we submit that it would be totally unacceptable to permit those institutions to operate under a different regulatory system than the one which now governs all other institutions engaged in the same activity. Section 302 of S.1720 would enable banking institutions to organize and advise their own investment companies and underwrite the shares of any other investment company. An investment company organized by a banking institution presumably would be required to register its shares under the Securities Act of 1933 and would itself be registered under the Investment Company Act of 1940. However, a banking institution underwriting the shares of any investment company would not be subject to the comprehensive provisions of the Securities Exchange Act of 1934.

Section 302 provides for an exclusion from the definition of the terms "broker" and "dealer" as used in the Exchange Act

with respect to savings and loan associations, savings banks or credit unions which engage in the functions described in that section. Similarly, the Exchange Act presently excludes banks from these definitions. The effect of both these exclusions is to exempt banking entities from the otherwise applicable regulatory provisions of the Exchange Act, because these provisions by their terms apply to brokers and dealers.

The existing exclusion of banks from the Exchange Act's definitions of "broker" and "dealer" must be analyzed in conjunction with the provisions and policies of the Glass-Steagall Act. As discussed earlier, one of the fundamental effects of passing that Act in 1933 was the separation of commercial banking from investment banking. Consequently, when Congress enacted the Exchange Act in 1934, many of its regulatory provisions had little, if any, application to commercial banks, since they had already been prohibited from performing customary broker/dealer activities such as underwriting corporate securities or trading such securities for their own account. To the extent S.1720 would once again permit banks to function as traditional broker/dealers, the basis upon which the original bank exemption from the Exchange Act was predicated would no longer exist. Likewise, to the extent the proposed exclusion of savings and loans, savings banks and credit unions was included in Section 302 in order to parallel the Exchange Act's exclusion for banks, the concept is similarly flawed, since these entities would also be permitted to engage in broker/dealer activities.

The preamble of the Exchange Act states that it was designed to prevent national emergencies which might result from manipulation and unreasonable fluctuation of securities prices and by excessive speculation in the securities markets. This fundamental legislative purpose would be thwarted by permitting the securities activities of banking entities to fall outside the boundaries of the Exchange Act.

In general, the Exchange Act is intended to control and regulate securities transactions for the purpose of protecting interstate commerce, safeguarding national credit and ensuring the integrity of the securities markets. More specifically, the Exchange Act provides that employees associated with a broker/dealer registered thereunder must satisfy standards of training, experience and other qualifications established by the SEC for the protection of investors. These standards are administered either directly by the SEC or indirectly by the NASD with SEC oversight. For example, a comprehensive securities examination must be successfully completed by all sales and investment advisory employees of a broker/dealer. All broker/dealers registered with the SEC are required to obtain an application for employment containing basic information as to each of their salesmen, including, among other things, business history, education, record of any denial or expulsion from registration with broker/dealers or securities exchanges, and arrest, indictment and criminal records. The Exchange Act arms the SEC or, indirectly, the NASD, with extensive disciplinary authority over broker/dealers and their employees through

specifically enumerated disqualification provisions. Disqualification serves as an effective barrier to protect investors against the entry of undesirable or unqualified persons into the broker/dealer business. In addition, the authority to revoke broker/dealer registration or censure salesmen from association with broker/dealers provides a proscriptive means to ensure conduct in the public interest.

The SEC is a repository of specialized expertise with respect to the marketing, purchase and sale of securities. Moreover, the SEC possesses extensive experience in recognizing and responding to developments and problems in the rapidly evolving area of money market mutual funds. In this respect, the SEC would be well suited to oversee, either directly or through the NASD, the marketing of bank sponsored investment companies or the underwriting of other investment company securities by banking institutions.

Section 302 of S.1720 proposes that, in lieu of SEC regulation, the distribution of investment company securities by depository institutions be governed by regulations--as yet unknown--developed and administered by bank regulatory bodies. This significant departure from traditional securities regulation of investment companies has neither been explained nor justified by the proponents of S.1720 and is, in our view, indefensible. There is simply no reason why bank salesmen of investment company securities should not be subject to SEC regulation, unless the banking entities desire to secure regulatory treatment different from that which they could obtain under the Exchange Act. We

do not believe banking entities merit any different treatment in this context. Moreover, if the proponents of this divergent regulatory scheme do in fact desire special treatment, their supporting rationale should be clearly stated so that members of the public can respond appropriately.

The situation is analogous to the involvement of life insurance companies, either directly or through subsidiaries, in the sale of investment company securities. Notwithstanding the fact that life insurance companies and the agents that sell their products are extensively regulated by state insurance authorities, these same companies and individuals are subject to the full gamut of regulation under the federal securities laws, including regulation under the Exchange Act, for purposes of their investment company activities. Agents must be duly licensed with the SEC or the NASD and the insurance company itself or a subsidiary thereof must be registered with the SEC as a broker/dealer. Similarly, once it was established that variable annuity contracts sold by life insurance companies constituted securities for purposes of the federal securities laws, variable annuity salesmen were required to comply with the provisions of the Exchange Act governing the sale of securities.

To permit banking institutions to be exempt from the broad regulatory provision of the Exchange Act would offend the principle of regulatory equality, and regulatory inequality portends unfair competition. It is unfair competition--and not additional competition--to which we object. The possibility of disparate

and possibly conflicting regulation, which we believe would inevitably result from empowering five federal bank regulatory bodies plus the SEC to regulate the same type of activity, should be avoided at all costs. Such a situation could foster serious competitive disadvantages between financial institutions that are not uniformly regulated. Indeed, the bill's objective of bolstering the banking industry by allowing entry into the securities business may, in the absence of equal regulation, jeopardize other competing segments of the financial industry, thereby causing a deterioration in the quality of the securities markets.

Conclusion

S.1720 is a comprehensive bill proposing many significant changes to the existing banking system. These changes are of great consequence to the economy and to the competitive balance among financial institutions. There are many issues raised in the bill, such as the propriety of banking entities entering the investment company business, which warrant much more thoughtful analysis than they have presently been afforded. Until this analysis has been completed, we do not believe S.1720 should be enacted.

We believe this type of further study would establish conclusively that, should banking institutions ultimately be permitted to sponsor investment companies and sell their shares, there is no demonstrable reason for their being afforded unique regulatory treatment under the federal securities laws. We therefore oppose in particular Section 302 of S. 1720.

The CHAIRMAN. Mr. Van Liew.

Mr. VAN LIEW. Mr. Chairman and member of the committee, I am Alfred Van Liew, executive vice president of the Rhode Island Hospital Trust National Bank. I am in charge of that bank's trust investment management division. We are a commercial bank with \$1.2 billion in deposits. We have 36 branches throughout the State of Rhode Island. The vast majority of our deposits are raised in the Rhode Island marketplace and most of the lending activity relates to Rhode Island borrowers. In fact, roughly 80 percent of our stockholders are Rhode Island residents.

INVASION BY NONBANKING FINANCIAL INSTITUTIONS

In brief, we are owned by and serve Rhode Islanders. What we face today is an environment that is quickly being invaded by nonbanking financial institutions. Our bank is unable to compete adequately in this new environment under present laws and regulations.

I would like to expand on that statement by describing what has happened to the nature of competition for core deposits and local investable funds.

In the past, our competition for deposits has been other banks and thrift institutions within the Rhode Island marketplace. Today that competition remains, but it has expanded to include large national brokerage houses, insurance companies, retail businesses, and many other large financial institutions. Recent newspaper articles describing the financial services above to be offered by American Express, Prudential Insurance, and Sears, Roebuck clearly indicate the trend.

Intermediation has traditionally occurred within the framework of banks and thrifts.

Now, however, money market funds participate in this process by taking what used to be our deposit dollars directly from customers and then, to a large degree, returning only a portion of the dollars to the banking system through the purchase of large CD's at selected banks. Since the rates the funds may pay are not regulated, they can offer a higher rate of interest to the consumer than we can and, consequently, have been rapidly garnering our deposits. A conservative estimate of \$100 million in Rhode Island money is invested in money market funds by brokerage firms in our immediate area.

Most of this money would otherwise have been in the Rhode Island banking system. However, if these funds do not buy CD's at local Rhode Island banks—and selections rarely include hospital trust or other Rhode Island banks—that money has left the community. There is no return on that money to the local banking community either as a deposit or in fees that would have been collected were we able to offer money market funds.

Due to this outflow, we find ourselves in a position where we are not only prohibited from using our expertise to generate additional business, but we also have to fight simply to retain our present customer base. The competition has an unfair advantage which has been successfully exploited because commonsense and increased sophistication has the consumer reaching for the highest rates available in the marketplace.

My purpose in mentioning all this is to make this point: other institutions that are not bound by the same laws which tie our hands can and do offer funds that attract the average investor and allow the firm to make a profit at the same time. These firms have no regulations that prohibit them from generating the volume necessary to make their required profit, and thus their funds are constantly growing. Many of the services these firms offer have been requested by our present customers but, by law, we cannot provide them. A nonbank financial services firm can virtually "capture the customer" by securing the core business—money market funds.

From this base the firm can then market a myriad of investment vehicles and financial services. Today's shopping list would include checkwriting, borrowing, and custodial as well as investment in equities, bonds, real estate, and other mutual fund products. Our offerings seem inadequate given the nature of the competition. To maintain our customer base, we are forced to find solutions under the present regulatory structure that offer minimal profitability, if at all. We call this in our organization, "shooting ourselves in the foot." An example is the banking industry's "stopgap" answer to the cash management account. At best, banks can offer an imitation product that will be some combination of checkwriting, credit extension, and money market fund participation.

A number of money market firms have recently formed alliances with banks for this same purpose—Dreyfus and Fidelity are two that immediately come to mind. The banks must pass on this money to the money market funds. Those firms are able to change management and administrative fees that represent most of the compensation for the entire product. In such a situation, the money market fund will reap the profit; the bank will be fortunate to break even. However, the Glass-Steagall Act prevents the bank from sponsoring underwriting, or advising a mutual fund.

Add to all of this the fact that recent studies have shown that most individuals would prefer to conduct their financial transactions with the local institutions that have been serving them for years. They have more faith in their neighborhood bank due to a close relationship from past association.

Competition is something we welcome because we have the resources and capabilities to provide the necessary services. However, under present regulations, particularly those of Glass-Steagall, we face laws that prohibit us from offering, producing, marketing, and managing the type of services necessary to compete in our own market. The services provided by our trust division generally appeal to those Rhode Islanders who have a high net worth and/or annual income in excess of \$100,000. Therefore, the management and investment expertise of our trust division is presently available only to a small percentage of our population. Over 46 percent of our local population—those with an annual income between \$20,000 and \$50,000—thus become prospects for money market funds and other services provided by nonbank, financial services organizations. These are services we are forbidden to offer under present law.

Our capabilities as qualified investment managers are severely diminished because we are unable to appeal to a sizable segment of

the population without a commingling of accounts and mass marketing of these services. This has proven unprofitable and unlawful in the past. Twice in our history we attempted to reach this market with products which had to be terminated because they were either thought to be in violation of Glass-Steagall or because of poor reception in the marketplace due to the necessity of extra consumer dollars being spent on legal fees for a trust agreement. The smaller investor does not want roadblocks.

If we were able to commingle our funds, we would have the ability to deliver the "economy of scale," and it would be possible for us to compete in a reasonable manner with other financial services institutions. Our expertise should then allow us to make our services available to a much broader base, and we could deliver vehicles such as money market funds to a greater number of Rhode Islanders.

In summary, Hospital Trust is a relatively small bank in a small State. Nevertheless, we are a well-managed financial services institution capable of providing services that are necessary and vital to our community. However, we want to do more but require a greater degree of regulatory freedom in order to do so. Our customers have expressed a desire for us to expand our services. They have stated that they would much prefer to deal with us through our extensive branch system than to go to an unknown, faraway firm that deals with them only by computer.

Therefore, we want to be deregulated on both price and product. We do not fear competing against large national organizations in Rhode Island, if we can do so on equal terms. Our capabilities in offering money market funds, equities, fixed income investments, real estate opportunities, gold investment, and others are sound and well-organized. Through the past 114 years we have successfully managed the dollars of thousands of Rhode Islanders. We have preserved and, where appropriate, built capital through sound investment for individuals and institutions in good times and in depressions and recessions.

We hope deregulation will allow us to offer these capabilities to the consumers of Rhode Island. Given deregulation, we feel confident that we can compete effectively for other types of financial services business within our own community. We fervently hope that through deregulation the antiquated laws that prohibit us from operating on terms that are feasible for fair competition will be amended.

If so, all organizations desiring to do business in the financial services field should be able to offer similar products, and the free enterprise system of competition will be restored to the financial services industry.

We applaud competition on equal terms. We urge the committee to focus on allowing the financial services industry to commingle their funds so that this equality will be achieved. Commingling would not only help restore our ability to compete but would allow us to better serve our Rhode Island community. At present, the scales are tipped in favor of the nonbanking sector of the industry.

All we ask is that they be righted on a level plane so that true competition will once again exist.

I would like to thank the chairman and the committee for being able to present our thoughts.

[Complete statement follows:]

TESTIMONY OF ALFRED B. VAN LIEW, EXECUTIVE VICE PRESIDENT, RHODE ISLAND HOSPITAL TRUST NATIONAL BANK

Mr. Chairman and members of the committee: My name is Alfred B. Van Liew, and I am executive vice president and head of the Trust and Investment Management Division of Rhode Island Hospital Trust National Bank in Providence, Rhode Island. Hospital Trust is a commercial bank with \$1.2 billion in deposits and 36 branches throughout the State. In 1867 we were created to serve as a trustee in financing the construction of what is now the State's largest hospital. Ultimately, we became a full service bank. The vast majority of our deposits are raised in the Rhode Island marketplace, and most of our lending activities relate to Rhode Island borrowers. In fact, roughly 80 percent of our stockholders are Rhode Island residents. In brief, we are owned by and serve Rhode Islanders.

What we face today is an environment that is quickly being invaded by non-banking financial institutions. Our bank is unable to compete adequately in this new environment under present laws and regulations. I would like to expand on that statement by describing what has happened to the nature of competition for core deposits and local "investable" funds.

In the past, our competition for deposits has been other banks and thrift institutions within the Rhode Island marketplace. Today, that competition remains, but it has expanded to include large national brokerage houses, insurance companies, retail businesses, and many other large financial institutions. Recent newspaper articles describing the financial services about to be offered by American Express, Prudential Insurance, and Sears Roebuck clearly indicate the trend.

Traditionally, banks have provided the largest part of financial intermediation in our economy. Now, however, money market funds participate in this process by taking what used to be our deposit dollars directly from customers and then, to a large degree, returning only a portion of the dollars to the banking system through the purchase of large CDs at selected banks. Since the rates the funds may pay are not regulated, they can offer a higher rate of interest to the consumer than we can and, consequently, have been rapidly garnering our deposits. A conservative estimate of \$100 million in Rhode Island money is invested in money market funds by brokerage firms. Most of this money would otherwise have been in the Rhode Island banking system. However, if these funds do not buy CDs at local Rhode Island banks (and selections rarely include Hospital Trust or other Rhode Island banks), that money has left the community. There is no return on that money to the local banking community either as a deposit or in fees that would have been collected were they able to offer a money market fund.

Due to this outflow, we find ourselves in a position where we are not only prohibited from using our expertise to generate additional business, but we also have to fight simply to retain our present customer base. The competition has an unfair advantage which has been successfully exploited because of the marked trend on the part of the consumer toward higher rate investment vehicles. There really is no way to pinpoint the "disintermediation" or outflow of funds from the banking system. However, the deposits our bank has retained and brought in over the past few years have clearly shifted to the higher rate vehicles. Increased sophistication has the consumer searching for the highest rates available in the marketplace. A recent study (Bruskin A.I.M.) confirms that people are now as interested in the investment of their money as they are in their personal health and more interested in finance than in a number of other traditionally strong interests. Under present laws only money market funds can pay the highest rates on short-term, minimum-balances.

My purpose in mentioning all this is to make this point: Other institutions that are not bound by the same laws which tie our hands can and do offer funds that attract the average investor and allow the firm to make a profit at the same time. These firms have no regulations that prohibit them from generating the volume necessary to make their required profit, and thus their funds are constantly growing. Many of the services these firms offer have been requested by our present customers but, by law, we cannot provide them. A non-bank financial services firm can virtually "capture the customer" by securing the core business—money market funds.

From this base the firm can then market a myriad of investment vehicles and financial services. Today's shopping list would include check writing, borrowing, and custodial as well as investment in equities, bonds, real estate, and other mutual

fund products. Our offerings seem inadequate given the nature of the competition. To maintain our customer base, we are forced to find solutions under the present regulatory structure that offer minimal profitability, if at all. An example is the banking industry's "stop-gap" answer to the cash management account. At best, banks can offer an imitation product that will have some combination of check writing, credit extension, and money market fund participation. A number of money market firms have recently formed alliances with banks for this same purpose—Dreyfus and Fidelity are two that immediately come to mind. The banks must pass on this money to the money market funds. Those firms are able to charge management and administrative fees that represent most of the compensation for the entire product. In such a situation, the money market fund will reap the profit: The bank will be fortunate to break even. However, the Glass-Steagall Act prevents the bank from sponsoring, underwriting, or advising a mutual fund.

Add to all of this the fact that recent studies have shown that most individuals would prefer to conduct their financial transactions with the local institutions that have been serving them for years. They have more faith in their neighborhood bank due to a close relationship from past association.

Competition is something we welcome because we have the resources and capabilities to provide the necessary services. However, under present regulations, particularly those of Glass-Steagall, we face laws that prohibit us from offering, producing, marketing, and managing the type of services necessary to compete in our own market. The services provided by our trust division generally appeal to those Rhode Islanders who have a high net worth and/or annual income in excess of \$100,000. Therefore, the management and investment expertise of our trust division is presently available only to a small percentage of our population. Over 46 percent of our local population—those with an annual income between \$20,000 and \$50,000—thus become prospects for money market funds and other services provided by non-bank, financial services organizations. These are services we are forbidden to offer under present law. Our capabilities as qualified investment managers are severely diminished because we are unable to appeal to a sizable segment of the population without a commingling of accounts and mass marketing of these services.

This has proven unprofitable and unlawful in the past. (Twice in our history we attempted to reach this market with products which had to be terminated because they were either in violation of Glass-Steagall or because of poor reception in the marketplace due to the necessity of extra consumer dollars being spent on legal fees for a trust agreement.)

If we were able to commingle our funds, we would have the ability to deliver the "economy of scale", and it would be possible for us to compete in a reasonable manner with other financial services institutions. Our expertise should then allow us to make our services available to a much broader base, and we could deliver vehicles such as money market funds to a greater number of Rhode Islanders.

In summary, Hospital Trust is a relatively small bank in a small state. Nevertheless, we are a well-managed financial services institution capable of providing services that are necessary and vital to our community. However, we want to do more but require a greater degree of regulatory freedom in order to do so. Our customers have expressed a desire for us to expand our services. They have stated that they would much prefer to deal with us through our extensive branch system than to go to an unknown, faraway firm that deals with them only by computer. Therefore, we want to be deregulated on both price and product. We do not fear competing against large national organizations in Rhode Island if we can do so on equal terms. Our capabilities in offering money market funds, equities, fixed income investments, real estate opportunities, gold investment, and others are sound and well-organized. Through the past 114 years we have successfully managed the dollars of thousands of Rhode Islanders. We have preserved and, where appropriate, built capital through sound investment for individuals and institutions in good times and in depressions and recessions.

We hope deregulation will allow us to offer these capabilities to the consumers of Rhode Island. Given deregulation, we feel confident that we can compete effectively for other types of financial services business within our own community. We fervently hope that through deregulation the antiquated laws that prohibit us from operating on terms that are feasible for fair competition will be amended. If so, all organizations desiring to do business in the financial services field will be able to offer similar products, and the free enterprise system of competition will be restored to the financial services industry.

We applaud competition on equal terms. We urge the committee to focus on allowing the financial services industry to commingle their funds so that this equality will be achieved. Commingling would not only help restore our ability to compete but would allow us to better serve our Rhode Island community. At

present, the scales are tipped in favor of the non-banking sector of the industry. All we ask is that they be righted on a level plane so that true competition will once again exist.

EXHIBIT A

RHODE ISLAND HOSPITAL TRUST NATIONAL BANK—FACTS AND FIGURES—ALL FIGURES ARE AS OF DECEMBER 31, 1980

A. Size

Hospital Trust is the 3rd largest bank in Rhode Island by deposits.
Hospital Trust is the 9th largest bank in New England by deposits.
Hospital Trust is the 135th largest bank in the United States by deposits.
Hospital Trust has deposits of \$1.2 billion and total assets of \$1.7 billion.

B. Stockholders

Hospital Trust has approximately 4,736 stockholders.
Hospital Trust stockholders are located in 30 different states with 80 percent in Rhode Island (nominee name makes it difficult to pinpoint the exact number).

C. Trust services

Hospital Trust has a large and efficient Trust and Investment Management Division: the largest in Rhode Island; the 7th largest in New England; the 68th largest in the United States.

D. Hospital Trust has a large commercial gold operation.

E. Fee income generated by Trust and Investment Management Division and gold operation: Trust and Investment Management Division, \$12,791,000, (18 percent);¹ gold operation \$2,546,000, (4 percent); all other fees, \$6,434,000, (9 percent); net interest margin \$49,525,000, (69 percent).

The CHAIRMAN. Thank you. Mr. Garver?

Mr. GARVER. Mr. Chairman, my name is Robert W. Garver, president and chief executive officer of the Charlestown Savings Bank in Boston, Mass., which is the fourth largest savings bank in our State and has assets of approximately \$800 million. I appreciate the opportunity to present my views today on the amendment to the Investment Company Act of 1940 authorizing depository institutions, including mutual savings banks, to organize and sell their own mutual funds.

I should emphasize at the outset that the position I am taking on this legislation does not necessarily reflect the views of the mutual savings bank industry. In order that you might fully understand my position, I would like to take a moment to describe the specific competitive situation in the market served by Charlestown Savings Bank before stating the reasons why I feel this expanded authority would be helpful to thrift institutions.

Boston, Mass., ranks second to none as a fiercely competitive financial marketplace. In fact, since 1978 we have had even more severe disintermediation than our sister savings banks in New York City. Charlestown's net deposits, which reached the high-water mark of \$745 million at yearend 1978, have dropped almost 10 percent in the 3 years since then to the current level of \$673 million. If you further deduct dividends credited during that period, our over-the-counter loss—that is, withdrawals in excess of deposits—totals approximately \$235 million, or almost one-third of the beginning deposit base.

ADVERSE DEPOSIT FLOWS

As you would expect, there has also been a continuing decline in the percentage of our total deposits represented by passbook sav-

¹ Percentage of income before operating expenses.

ings. In 1978 we had \$339 million in regular accounts, over 45 percent of our total deposit base, whereas at the end of September 1981 they aggregated only \$223 million, 33 percent of the total. The pace of transfer has increased recently, primarily the result of the all savers certificate, about which I'll comment later.

These very adverse deposit flows, which are more or less typical for large mutual savings banks in the city of Boston, have created several problems, including strained liquidity; loss of customers to both regulated and unregulated competitors; and, in many cases, the reluctant and, indeed, painful decision to discontinue home mortgage lending. They have also produced a drastic reduction in our earnings, although Massachusetts savings banks are significantly better off than some other segments of the thrift industry. In fact, on an aggregate basis, we will approximately break even in 1981. The trends, however, are ominous and unmistakable.

Given the background let me now cite the specific advantages which I feel the authority to offer a money market mutual fund would produce for the Charlestown Savings Bank. First and foremost, it will give us at least a chance to hold onto some of our current customers who, as the figures suggest, have been leaving in large numbers to take advantage of the new financial products available elsewhere. There is a school of thought which suggests that when and if interest rates return to more "normal" levels, these dollars and depositors will pour back into our vaults and lobbies.

Given the innovative skills of our competitors, particularly those who are unregulated, I think that is both dangerous and wishful thinking. In short, I would much prefer to retain customers even at a higher short-term cost than to lose them, possibly forever.

Second, this will give us a chance to attract new customers with a product of proven popularity and profitability. While it would not improve our liquidity position and could even temporarily impair it through transfers from existing accounts, the advantages of establishing a new base of customers would, in my view, more than offset that problem.

A third benefit would be the ultimate boost to our earnings position as the money market fund operation became profitable. I say ultimate because clearly the short-term impact would be negative until such time as a break-even point was reached and exceeded. We have done studies which indicate that we could be making money in between 1 and 2 years, based on assumptions which we feel are reasonable. Also the fee income would add an element of stability to overall revenues which I think most thrift institutions would view as desirable.

Finally, the ability to offer a money market fund or, for that matter, any type of Mutual Fund would move us closer to becoming "full service" institutions. Having worked for 8 years in a large commercial bank in Chicago before entering the mutual savings bank industry, 13 years ago, I have seen firsthand the very substantial advantages and flexibility which full service institutions possess and which, in my opinion, a thrift institution in 1981 needs to survive.

I would like to briefly comment on the two most often cited disadvantages of extending money market fund authority to thrift

institutions. First, and foremost, it is said that we will "cannibalize" our existing passbook accounts and thereby greatly increase the cost of our operations without significantly improving our revenues. I would suggest that this is happening already and would cite as a current example our experience with the all savers certificate. Prior to the introduction of this tax-exempt account, we prepared a "pro forma" wherein we made certain assumptions regarding the amount of transfers and new money which the all savers certificate would produce.

It was at that time that we recognized the possibility that significant transfers upward from our low-cost savings accounts would reduce the much publicized advantage of transfers down from money market certificates.

In fact, while we projected outstanding all savers balances at the end of 1982 of approximately \$120 million, this increased our net income by just \$75,000 on an annual basis which, if accurate, I am sure disappoints not only thrift executives but regulators and the Congress as well.

For the first 2 weeks in October, our experience was worse than projected—33 percent of total dollars on all savers came from regular accounts, 21 percent from money market certificates and only 19 percent in new money. Obviously, there are banks who have done better than that, but my point is simply that the level of sophistication, not to mention the financial needs, of our depositors, will continue to reduce our regular account balances, with or without money market fund authority.

A second argument not so frequently heard but often implied, if not stated, is that we somehow lack the expertise to offer these more sophisticated and presumably high-risk banking services. That may have been true 10 years ago, but at least in the case of my institution, and indeed many others in my industry, it is not true today. In the last 5 years, thanks to a progressive regulatory and legislative climate in Massachusetts, we have expanded into unsecured commercial lending, the acquisition of nondeposit liabilities, such as retail repurchase agreements participation in joint real estate ventures, and most recently usage of newly authorized trust powers.

Based on my admittedly surface knowledge of the mutual fund business, I doubt that it is as complex as most of those activities just cited. Also, as a regulated industry, we clearly would have to prove our initial and continuing competence to be allowed to provide this service.

Before concluding, I would like to comment on Treasury Secretary Regan's position that only bank holding companies should be initially authorized to offer money market funds. This, in my opinion, would be poor public policy and contrary to the intent of the Congress to produce a so-called "level playing field." To place the thrift industry at a further disadvantage with regard to one of our major competitors at this point of vulnerability, could do nothing but further exacerbate our problems and lessen the chances that we can retain our independence as providers of financial services.

In summary, if I had any hope that some kind of meaningful and effective restrictions could be placed on the unregulated competition which we presently face, I might take a different position on

this specific issue. The fact is, however, the Congress does not seem so inclined, and even if they were, new innovations would undoubtedly spring up to keep the pressure on my industry.

The only realistic solution in my view is for thrift institutions, at the earliest possible date, to be given those powers, including that addressed by this legislation, which will allow us to retain, and hopefully expand, our current customer base. There may well be short-term costs associated with this but I, for one, am willing to accept those as the price necessary to survive as an independent and useful financial intermediary in the future.

Thank you very much, sir.

[Complete statement follows:]

STATEMENT OF ROBERT W. GARVER, PRESIDENT, CHARLESTOWN SAVINGS BANK,
BOSTON, MASS.

Mr. Chairman, my name is Robert W. Garver. I am President and Chief Executive Officer of the Charlestown Savings Bank in Boston, Massachusetts, the fourth largest savings bank in the State with assets of approximately \$800 million. I appreciate the opportunity to present my views today on the Amendment to the Investment Company Act of 1940 authorizing depository institutions, including mutual savings banks, to organize and sell their own mutual funds.

I should emphasize at the outset that the position I am taking on this legislation does not necessarily reflect the views of the mutual savings bank industry. In order that you might fully understand my position, I would like to take a moment to describe the specific competitive situation in the market served by Charlestown Savings Bank before stating the reasons why I feel this expanded authority would be helpful to thrift institutions.

Boston, Massachusetts, ranks second to none as a fiercely competitive financial marketplace. In fact, since 1978 we have had even more severe disintermediation than our sister savings banks in New York City. Charlestown's net deposits, which reached the high-water mark of \$745 million at year-end 1978, have dropped almost 10 percent in the three years since then to the current level of \$673 million. If you further deduct dividends credited during that period the over-the-counter loss—that is withdrawals in excess of deposits—totals approximately \$235 million, or almost one-third of the beginning deposit base.

As you would expect, there has also been a continuing decline in the percentage of our total deposits represented by passbook savings. In 1978 we had \$339 million in regular accounts, over 45 percent of our total deposit base, whereas at the end of September 1981 they aggregated only \$223 million, 33 percent of the total. The pace of transfer has increased recently primarily the result of the All Savers Certificate, about which I'll comment later.

These very adverse deposit flows, which are more or less typical for large mutual savings banks in the City of Boston, have created several problems, including strained liquidity; loss of customers to both regulated and unregulated competitors; and, in many cases, the reluctant and, indeed, painful decision to discontinue home mortgage lending. They have also produced a drastic reduction in our earnings although Massachusetts savings banks are significantly better off than some other segments of the thrift industry. In fact, on an aggregate basis we will approximately break even in 1981. The trends, however, are ominous and unmistakable.

Given the background let me now cite the specific advantages which I feel the authority to offer a money market mutual fund would produce for the Charlestown Savings Bank. First and foremost, it will give us at least a chance to hold on to some of our current customers who, as the figures suggest, have been leaving in large numbers to take advantage of the new financial products available elsewhere. There is a school of thought which suggests that when and if interest rates return to more "normal" levels, these dollars and depositors will pour back into our vaults and lobbies. Given the innovative skills of our competitors, particularly those who are unregulated, I think that is both dangerous and wishful thinking. In short, I would much prefer to retain customers even at a higher short-term cost than to lose them, possibly forever.

Second, this will give us a chance to attract new customers with a product of proven popularity and profitability. While it would not improve our liquidity position and could even temporarily impair it through transfers from existing accounts, the advantages of establishing a new base of customers would, in my view, more than offset that problem.

A third benefit would be the ultimate boost to our earnings position as the Money Market Fund operation became profitable. I say "ultimate", because clearly the short-term impact would be negative until such time as a break even point was reached and exceeded. We have done studies which indicate that we could be making money in between one and two years, based on assumptions which we feel are reasonable. Also, the fee income would add an element of stability to overall revenues which I think most thrift institutions would view as desirable.

Finally, the ability to offer a Money Market Fund or, for that matter, any type of Mutual Fund would move us closer to becoming "full service" institutions. Having worked for eight years in a large commercial bank in Chicago before entering the Mutual Savings Bank Industry, I have seen firsthand the very substantial advantages and flexibility which full service institutions possess and which, in my opinion, a thrift institution in 1981 needs to survive.

I would like to briefly comment on the two most often cited disadvantages of extending Money Market Fund authority to thrift institutions. First, and foremost, it is said that we will "cannibalize" our existing passbook accounts and thereby greatly increase the cost of our operations without significantly improving our revenues. I would suggest that this is happening already and would cite as a current example our experience with the All Savers Certificate. Prior to the introduction of this tax-exempt account, we prepared a "pro forma" wherein we made certain assumptions regarding the amount of transfers and new money which the All Savers Certificate would produce. It was at that time that we recognized the possibility that significant transfers upward from our low-cost savings accounts would reduce the much publicized advantage of transfers down from Money Market Certificates. In fact, while we projected outstanding All Savers balances at the end of 1982 of approximately \$120 million, this increased our net income by just \$75,000 on an annual basis which, if accurate, I am sure disappoints not only thrift executives but regulators and the Congress as well.

For the first two weeks in October, our experience was worse than projected—33 percent of total dollars on All Savers came from regular accounts, 21 percent from Money Market Certificates and only 19 percent in new money. Obviously, there are banks who have done better than that, but my point is simply that the level of sophistication, not to mention the financial needs, of our depositors, will continue to reduce our regular account balances, with or without Money Market Fund authority.

A second argument not so frequently heard but often implied, if not stated, is that we somehow lack the expertise to offer these more sophisticated and presumably high-risk banking services. That may have been true ten years ago, but at least in the case of my institution, and indeed many other in my industry, it is not true today. In the last five years, thanks to a progressive regulatory and legislative climate in Massachusetts, we have expanded into unsecured commercial lending, the acquisition of non-deposit liabilities, such as Retail Repurchase Agreements, participation in joint real estate ventures, and most recently usage of newly-authorized trust powers. Based on my admittedly surface knowledge of the Mutual Fund business, I doubt that it is as complex as most of those activities just cited. Also, as a regulated industry, we clearly would have to prove our initial and continuing competence to be allowed to provide this service.

Before concluding, I would like to comment on Treasury Secretary Regan's position that only bank holding companies should be initially authorized to offer Money Market Funds. This, in my opinion, would be poor public policy and contrary to the intent of the Congress to produce a so-called "level playing field." To place the thrift industry at a further disadvantage with regard to one of our major competitors at this point of vulnerability, could do nothing but further exacerbate our problems and lessen the chances that we can retain our independence as providers of financial services.

In summary, if I had any hope that some kind of meaningful and effective restrictions could be placed on the unregulated competition which we presently face, I might take a different position on this specific issue. The fact is, however, the Congress does not seem so inclined, and even if they were, new innovations would undoubtedly spring up to keep the pressure on my industry. The only realistic solution in my view is for thrift institutions, at the earliest possible date, to be given those powers, including that addressed by this legislation, which will allow us to retain, and hopefully expand, our current customer base. There may well be short-term costs associated with this but I, for one, am willing to accept those as the price necessary to survive as an independent and useful financial intermediary in the future.

The CHAIRMAN. Thank you, Mr. Garver.

Mr. Silver, I appreciate the detailed nature of your testimony and also the fact that it will be included in the record without us having to—for those of you who don't know and have not seen, here it is [demonstrating]. Much of the information will be helpful in our deliberations.

But beyond that, I think I can sum up your testimony in this way, that we are first raising the specter of the horrors of the 1920's and the 1930's, and relating them to the 1980's without any regard to all of the additional safeguards FDIC, FSLIC. It's good. It is impressive to some. Let's not let those banks out, because we are going to have a repeat of the 1920's. So we are turning the clock back to the 1920's.

And another good theme that always runs very well is the big banks. Chase Manhattan, I use them myself. I constantly talk about how Citicorp and Chase Manhattan do not need Jake Garn's help. They will survive quite nicely without me. But I am tremendously concerned about the smaller institutions. So no matter how much we raise the ghost of the 1920's. No matter how much we talk about the big boys, I am concerned about the 14,000 or 15,000 banks and savings and loan and credit unions out there. That's just financial institutions. That does not even include the credit unions who are being killed by the unfair competition.

NO COMPETITIVE EQUITY

I agree with competitive equity. It does not exist. I salute the securities industry for being innovative. I'm not one who wants to place any more rules and regulations on you.

But the hypocrisy of this type of a situation to, say, keep everybody locked up. My God, don't go back to the 1920's. Keep them all locked up. Don't let them out. While we just run roughshod because of the high interest rates. That's not going to happen.

There are two ways to go. I don't know what the votes will be. I do not know how this will turn out, but I guarantee you there is not competitive equity now. Whatever this Senator can do to correct that, so that there is a reasonably level playing field, will be done.

I do not want to impose new rules and regulations on you. I want to leave you alone. I will guarantee you that I do not accept the specter of the 1920's, and I do not expect to sit here and just hear about the big banks. I am going to try to do something about it. And then if institutions fail; fine.

But the main reason you're doing so damn well right now is high-interest rates and the Government holding down your competition. And that's where I really get riled up about the unfairness of the competition, it is because Government is the one that's making it unfair. If you are competing with Mr. Garver on a fair basis and he goes out of business; fine. So be it. But Government is holding him down arbitrarily with some old rules and regulations that may or may not relate to the 1980's.

Let us be realistic about it. Please don't sit there and tell me that you guys are not in the banking business with CMA's and checking accounts. What Mr. Cantor says is absolutely correct. He says everybody ought to be under the same terms and regulations.

If banks are going to get into the securities business, they ought to be regulated by the SEC.

That's a good principle, I suppose, but it is just as fair to say that if the securities industry is going to get into the banking business, then let's have the Fed and the FDIC, FSLIC regulate it. But you do not accept that. You just can't have it both ways, not as far as this Senator is concerned. That's true. They should be regulated equally. Then get out of the checking account business. Don't sit here and insult my intelligence over and over and over again, by telling us that you are not at least in the fringes of the banking business.

You are. That's what has created this situation.

The other argument always used in this committee, or some others as well, is, it does not matter what the issue is; if it is something that you do not like, then we also not only raise old fears, but we say, "Let's not do this precipitously. Let's study it carefully through the next 20 or 30 years." [Laughter.]

The CHAIRMAN. I wish somebody would come up with a new argument. Some staff member from some organization sooner or later ought to be able to come up with a new argument, other than, "Let's not do it now." These are not new issues. Precipitously? There is not an issue in this bill that was not being discussed before I became a U.S. Senator. I do not know how long before that they were around. There is not a new issue here at all. Municipal revenue bonds have passed the Senate before. Not just been discussed—passed the Senate. So there is nothing new. Nothing has gone on precipitously.

Mr. Silver, your statement emphasizes potential problems which would arise from concentration of economic powers in a few large banks. Can you identify any recent trend which has been more proconcentration than the growth of money market funds. They have attracted funds from all 50 States and channeled these into the country's biggest banks in the money market centers of this country. Drained money out of my State, drained it out of the small institutions, taken it away from local mortgages and so on. I can think of nothing that illustrates our concern about big banks more than the amount the money market funds have piled in the big banks in New York and the other money centers of this country. Are there any other trends you can identify that are more proconcentration than exactly what has been going on?

Mr. SILVER. I tried to emphasize in my testimony, I think, that there is a unique aspect to the commercial banking business and that is the unique banking relationships which banks ordinarily enjoy with their customers. The money market funds are passive investors. They do recycle the money and you're quite right, the money moves around the country through the medium of the money market fund. However, our concern is, as I express it, and this is related to the concentration point, that once a bank moves into a new financial business, then with its core business being the commercial banking business, that bank has a competitive advantage over the financial services institutions it is competing with.

Moreover, I thought we did say something new today. I thought we did say that we are not standing pat in our position, but our concern is that the legislation, as it affects the mutual fund indus-

try, is a one-way street. Banks will remain protected with an exclusive franchise in the banking business. If I thought we were in the banking business and my industry thought we were in the banking business, we would not be here today asking for bank charters as fair reciprocity for bank entry into the securities business. We want to compete on the same terms, as Mr. Van Liew puts it, with banks. We cannot compete in Rhode Island when he is in the banking business and in the mutual fund business, and we are only in the mutual fund business.

The CHAIRMAN. Your statement indicates that S. 1720 would afford certain large banks, as you just said, a one-way competitive advantage, not only enabling those banks to compete for securities business but also insulating the same banks from meaningful competition in the banking business from the securities industry. Does Shearson operate mutual funds in addition to the brokerage business?

Mr. SILVER. Yes, sir.

The CHAIRMAN. Do they also own a bank?

Mr. SILVER. They own a trust company, I believe, in Boston.

The CHAIRMAN. Is Fidelity Management one of the largest mutual fund companies? Does it own a bank?

Mr. SILVER. They own a noncommercial bank that does not make commercial loans.

The CHAIRMAN. They do own a bank. Does Sears, which takes deposits through an S. & L. subsidiary and operates a full brokerage business, undermine the principles of Glass-Steagall?

Mr. SILVER. I believe that you are referring to the holding company complex, an S. & L. in California. I'm not acquainted with it.

The CHAIRMAN. Yes, they do. Does the Glass-Steagall Act prohibit such combinations?

Mr. SILVER. As I suggested in my testimony, Senator, we recognize that the Glass-Steagall Act should be revisited. I think that the three instances you have mentioned are examples of reasons for revisiting the Glass-Steagall Act. I would suggest that entry is not open to the banking business generally. These are very specific and unique examples you have given us. I do not think that either the securities industry generally or the mutual fund industry in particular believes that they have free access to the banking business.

If, by your question, you are suggesting that perhaps access to banking should be opened up so that there was a true two-way street rather than these odd examples which are really historical accidents; if there is a true two-way street, then I think we would have come a long way toward achieving a playing field which is level on both sides of the 50-yard line.

The CHAIRMAN. I'm only using a few examples, as you did, on the other side. I could produce documents this thick, all sorts of examples like that. They are not isolated. They are not historical accidents. I think everybody is aware that the marketplace is dramatically changing, and I do not know where that balance is. Certainly you are right in some of your comments. Certainly there are some inequities on the other side, no doubt about it. But this \$150 or \$160 billion and where it is coming from is a result of high-interest rates, and we simply have to look at those laws and try to decide

where the new balance point is. I have no preconceived ideas, other than the fact that it is tremendously unbalanced in favor of your industry because of a number of factors.

I could go on. You've used three or four examples. I have used three or four examples the other way. Securities people being involved in the banking business. We just let the thrifts have checking account authority the 1st of January this year. Merrill, Lynch can say, hey, no problem, we're not in the banking business because we write checks on CMA's. We do not have them written under \$500. But I have seen \$2 and \$3 and \$7 checks, the gas bill paid with it. Well, we can't control it, our rules are such.

I think it is time we all quit kidding each other. The ABA testimony was not scintillating on Tuesday. The game goes on. Everybody comes in here holier than thou, and pure, and we are the nice guys and somebody else is the bad guy. When are we going to get realistic and get up on top of the table and try to come to a solution? That's all I'm trying to do. I'm trying to find where that middle ground is. I realize it will never be found. There is always going to be some inequities. But you have got to try and balance it as carefully as you can.

I am not going to sit back and let the little institutions of my State be absorbed, unless they are absorbed and go out of business in fair competition. We see money being taken out of rural States like mine, so don't bring up the specter of the big boys. They will take care of themselves, whether they are in the securities business or the banking business, regardless of what you and I do. I'm worried more about the mass of small institutions that have served this country so well and so long, and who will continue to do so if they have a fair, competitive playing field to work on.

NEW YORK CITY FUNDING CRISIS

Mr. Silver, I note with interest your use of the 1974-75 New York City funding crisis as a reason to keep banks out of securities activities. The final report of the Securities and Exchange Commission regarding the issuance and sale of New York City securities, the SEC indicated, and I quote,

After thorough consideration of various alternatives which might be taken, including the possibility of enforcement actions, the staff recommended and the commission has concluded that the public interest will best be served by commission efforts in support of legislative solutions to the complex problems existing in the mutual securities field.

The commission went on to say in its final report that the Federal loan legislation in 1978 went a long way in opposing appropriate financial controls over the city, including financial statements. With regard to the principal underwriters of the city's securities in 1974-75, you are correct that the banks were significant participants in that. But do not forget that Merrill, Lynch was also a principal underwriter.

1974-75, New York City's situation was not the work of bankers alone. The city fathers were severely criticized by the SEC and Congress for slipshod and inefficient, inadequate financial disclosure and financial management. I sat through all of those hearings as a member of this committee. I think it is unfair to try and indicate in your testimony that it was primarily the responsibility

of the banks. We can get back to John Lindsay's term and all sorts of things on the city's side, but they also criticized the bond council, the bond rating agencies.

So if you are suggesting that the banks alone were primarily to blame for New York City's problems, I think Merrill, Lynch has to share in that. I think the city has to share. I think the bond underwriters have to share. I think the bond rating agencies have to share as well. I do not think that we can keep the California, Utah, or Wisconsin banks or any other State from expanded security activities on the basis of the conduct of banks in New York City in 1975. We have to restrict Merrill, Lynch from cash management and other bank-like activities. What about Standard & Poor's and Moody's, the venerable rating agencies and their participation? Would you like to reply?

Mr. SILVER. Yes, I would, sir. First, I was not referring to this example as a reason for keeping the banks out of the securities business. The example, as I stated, was for the purpose of showing the kind of rules that should be applied to prevent abuses. And I suggested that there were problems unique to the banks on the sales end which were not shared by other participants in the distribution of New York City securities.

Now, I fully agree with you that there is enough blame for all concerned, but I was focusing on the sales abuses, the emptying out of such inventories to the general public and into trust accounts that did not occur with respect to any brokers, as far as I understand. And the specific example was directed at the need to extend the Securities Exchange Act controls, the broker dealer controls that Mr. Cantor was talking about, over bank securities activities. That was the purpose of the example and that is what was intended to be illustrated.

The CHAIRMAN. I cannot be convinced that anybody involved in the 1974-75 New York situation deserves any more or less blame than some of the other participants. I am certainly not advocating that we restrict the activities of Standard & Poor's because of their investment grade ratings for New York City securities, either. Even if your statement is correct, I do not think that we can apply to the whole banking industry nationwide, because of what a few banks did in New York City in 1974 and 1975 in concert with a lot of other people who blew it at that time, as well.

Mr. Cantor, you mentioned that providing banks with additional securities activities under this bill will clearly contradict the legislative intent of the Glass-Steagall Act and would conflict directly with those provisions of the act which sought to limit the securities activities of commercial banks. Isn't the legislative intent of Glass-Steagall under attack from many sides?

Mr. CANTOR. Yes, Senator. I would point out that we have clearly indicated that we are not prepared to take a position on whether Glass-Steagall should ultimately be modified in this respect. All we are saying is that before a fundamental public policy position taken by the Congress in 1933 is abrogated, it ought to be studied in depth. Our position fundamentally is, though—and I really suppose that, in view of your statement that you agreed with me, if I had any common sense I would keep quiet—that even if Glass-Steagall is to be abrogated in this sense, our main concern is

achieving regulatory equality with the banks. We are not concerned about their competing with us in the securities business. All we ask is that they be required to compete with us on the same basis as we are required to compete from a regulatory standpoint. That means the full jurisdiction of the SEC, including the broker/dealer requirements of the 1934 act.

We, ourselves, are at a stage where we, too, need to diversify the kinds of things that we do because of the impact of the economy on us. Our problems in these respects, by reason of the McCarran-Ferguson Act and State regulation, are with the State regulators who determine what we can and cannot do, as a matter of business activity. Should we get the kinds of powers to do the kinds of things that would put us in competition with the banks, we are perfectly willing to do so under the same regulations to which they are subject.

We think the so-called level playing field that everybody wants to play on does suggest that if they are going to compete with us in these fields, they be subject to the same rules. That is fundamentally what we are saying.

The CHAIRMAN. I do not disagree in principal. But then I will repeat the question which I asked earlier. Isn't it fair, with CMA's and checking and so on, to make the same claim that they ought to be regulated as well, and have reserve requirements like checking accounts do in commercial banks and in S. & L.'s?

Mr. CANTOR. Yes, assuming this activity is ultimately determined to be the business of banking. I see no problem, no reason to feel that, if someone else wants to compete with banking entities in the things that they do, they be regulated in the same way.

The CHAIRMAN. The securities industry will not admit that.

Mr. CANTOR. I speak for the life insurance business.

The CHAIRMAN. I made my living in the life insurance business for 15 years, and I was silly enough to leave it for this body. It shows my level of intelligence. [Laughter.]

Mr. CANTOR. I think we have many problems now that you would not have recognized back then in the life insurance business.

The CHAIRMAN. I talk to my former partner a great deal about it, and I think it illustrates the point very well. It has changed very dramatically. After 9 years away I would have to go back and start from scratch to learn the business over again. That is why I do not think it is particularly relevant to talk about the 1920's and the 1930's and not recognize that there have been dramatic changes in the banking business, the securities business; electronic funds transfers, all sorts of things that are so dramatically different. And again, I do not know how Glass-Steagall ought to be changed. When we get into the full ramifications of it next year, and McFadden. I have no particular preconceived ideas about it. But I certainly think it is an incredibly different market, not only from 50 years ago but just over the last 5 or 6 or 10. We have got to take a look at it.

Mr. CANTOR. May I suggest, as I am sure you know, that if you were to go back into the life insurance business, you would have to be appropriately licensed and regulated and qualified. And probably today you would probably also have to be appropriately registered and licensed under SEC regulations. And all we are saying is

that anybody else that wants to come into the business that we engage in ought to play on the same playing field.

The CHAIRMAN. I don't disagree in principal. The securities people are going to have to learn that they cannot go North across the Yalu without the banks being able to come south. It reminds me of the Korean war. Our pilots could not go North. Their's could come South and raid all they wanted, but we could not go the other way. The securities people are saying keep the banks all tied up, don't let them out. But let us raid all we want.

BANK ADS HAVE BEEN MISLEADING

Mr. Silver, your statement alleges that bank ads for retail repurchase agreements have been misleading. Probably it's true. Isn't it a fact that many ads for money market mutual funds have been highly criticized for using terms designed to make the accounts appear to be analagous to insured deposits? I have certainly seen some that would give me a very definite impression that these were just like insured accounts.

Mr. SILVER. With respect to any misleading impression you have received from specific ads the SEC ought to take those up—but the differences, of course, that with the retail repo ads is that you read an ad and you buy the certificate. There is nothing in between. You do not receive any disclosure whatsoever with respect to these short-term notes. These are just run of the mill short-term notes, which, if issued by an industrial issuer, would have to be preceded or accompanied with a document which described the true financial condition of the issuer.

No such protection is being afforded here, and these are not insured investments. If in the comparison between a securities firm and a bank, certainly the impression among investors would be that something purchased from a bank is subject to FDIC. These are not. Certainly, special care should be taken, when the security is being issued by an institution whose financial condition was such that if that institution were subject to normal SEC requirements, total and complete disclosure would have to be made about its financial condition.

The CHAIRMAN. My point is simply there have been misleading ads on both sides. With the great SEC, in all of its detailed disclosure, do you believe that all of your money market fund shareholders understand the terms of their investments?

Mr. SILVER. Certainly, Senator, I cannot represent that 11 million shareholders all understand everything about their investment. What I can say is the documents which enable them to understand their investments are provided to them.

With respect to retail repos, there is no disclosure at all. There is no legal requirement whatsoever that the investor be told anything about the financial condition of the institution issuing this security.

The CHAIRMAN. Would you feel that the level of understanding as a result of that being filed someplace is much higher among shareholders than those who bought repos?

Mr. SILVER. I think under our system, Senator, those of us—you and I—who want to buy a money market fund share or buy a retail

repo have the right to have available the financial condition of the institution on whose credit we are relying.

The CHAIRMAN. I do not disagree with you, technically and legally speaking. I am just simply saying that the level of understanding—I do not think the legal qualification makes much difference. Over and over again, especially last spring when the Utah Legislature was involved in trying to restrict money market fund activities in the State, it was absolutely amazing to me, despite whatever the SEC requires, a large number of people in my State who assumed—and this was personal contact with them, receiving letters—that money market funds were insured. As a matter of fact, because of what they had been reading in the papers about the depository institutions funds outflows. There was a very distinct impression that they were taking their money out of depository accounts and putting them into money market funds, because they were safer.

So whatever the legalities are, I am talking about the pragmatic realities of perceptions. And there has been a lot of misleading stuff on both sides. I would suggest that the average person buying a mutual fund or a repo is confused about what they have. They are not sophisticated enough to ask for that statement, whether it exists, or not.

Mr. SILVER. Senator, I agree with you. But I would have to add that if the financial statement of certain institutions issuing these retail repos, their current financial condition were publicly available, the media would take care of informing the public very well about whether the public should buy a repo from that specific institution.

The CHAIRMAN. You have a higher confidence in the ability of the media to inform people than I do.

Now, let me ask you the next question. If you feel so strongly about this, then why, when you are involved with checking accounts, why you should not be subject to the same rules and regulations of the depository institutions? Why shouldn't you have reserves?

Please make a differentiation between what you have just said and the eloquent case you have made for forcing banks, if they get into the repos, to do this. And when you are involved in the checking account business, why shouldn't the same rules apply to you as to the banks and the thrifts?

Mr. SILVER. At this point, Senator—and I think that the regulatory authorities still agree, and the last I heard, so did Chairman Volcker—you will hear from him next week—his view seems to be that the Fed should have authority to impose reserves on money market funds. But the facts are, and he agrees with those facts, that the money market funds are not now engaging in activity or which reserves should be placed. At the level of the checking activity, which runs about two checks per year, those accounts show the same characteristics as savings accounts, on which there are no reserve requirements.

And therefore, the facts at this point, and until today, clearly demonstrate that were reserve requirements apposite to money market funds, they should not be applied simply because the competitive format in which they fit, their characteristics, their turn-

over of 2½ times a year, the number of checks written on these accounts, clearly demonstrate that they are competitive with savings accounts, and not with checking accounts.

The CHAIRMAN. As I have said many times before, I do not have the disadvantage of being an attorney to hide behind the fine legal distinctions. I think the practicalities of the situation are that people recognize that they are checking accounts, in direct competition. And the average is not two per year. The last figures I heard were two per month.

Mr. SILVER. No, sir.

The CHAIRMAN. That is testimony from your own organization before the Utah legislature, that it was an average of two per month. But I am not going to argue with you about it.

I am just saying that the realities are that you are in the checking account business. You can find the law, find the technicality, dot the "i," cross a "t" and I suppose you can prove it in a court that you are not. I am not with Mr. Volcker. I do not want to put reserves on you. I sincerely don't. I have said that over and over again.

Your testimony points out the danger of allowing further concentration of power in banks.

But according to the 1980 Wall Street Letter, the 10 largest institutional investors are as follows: No. 1, Prudential Insurance; No. 2, Morgan Guaranty; No. 3, Metropolitan Life; No. 4, Citibank; No. 5, Equitable Life; No. 6, California Public Employees Retirement System; No. 7, Aetna Life; No. 8, Bankers Trust; No. 9, Scutter-Stevens; No. 10, Travelers Insurance. As I see it, there are five insurance companies, three of them in the top five; three are banks. Are you also concerned about the large concentration of power in the insurance companies?

Mr. SILVER. I think I am fortunate enough to have Mr. Cantor on the panel to respond to that portion of it. What I can say is banks currently hold in their trust departments, in their commingled funds, \$500 billion in equity and corporate debt securities. No other institution of our financial life—investment advisors or insurance companies—has holdings of that magnitude.

Just to make the comparison, we get mesmerized by the money market funds. Yes, there are \$150 billion of short-term debt instruments in money markets, but against the \$500 billion in equities that banks hold, the mutual fund industry holds something like \$30 billion in their equity funds. There is no comparison between the securities industry and the banking industry in this regard.

The CHAIRMAN. When you say "banking industry," again, let's separate from the vast majority of the banks in this country who are not involved in that, who are the ones that I am concerned about.

Again, I do not worry about Citicorp being able to adequately take care of themselves. They will do so; and the other large institutions. I am talking about the vast majority of the institutions in this country, the little boys, who have my checking account and my savings account, and serve the vast majority of the people in this country—not the biggies.

Mr. SILVER. I am interested to hear that there are two representatives of depository institutions on this panel which are not the

largest in the country sincerely believing that they would like an opportunity to go into the securities business. But I can assure you that if the Glass-Steagall Act is opened up, you and I know, from what you have just said, who will be the biggies in the securities business. It is not going to be banks in Rhode Island, and it is not going to be banks in Massachusetts. It is going to be banks in New York, Illinois, California, and perhaps Texas. And we can probably name them.

The CHAIRMAN. Mr. Garver, how do you respond to that? You have testified that you think it would benefit you as a small institution. You have to deal with the big boys now, in other areas of service, but apparently you do it quite well.

Mr. GARVER. My position really is that we do not have a lot of choice. As I said in my testimony, if I had my druthers, I would like to go back 20 years and have passbook accounts and make home mortgage loans.

The CHAIRMAN. So would I. So would I.

Mr. GARVER. Unfortunately, it is a different world today, and with all due respect to Mr. Silver, I think the trends are very clear. \$160 billion may be a lot less than the commercial banks, especially when you include their fiduciary activity, but the growth rate is alarming, at least to a smaller thrift institution in the city of Boston. We compete with, as I said earlier, a very active banking market in Boston. Our major competitors are the commercial banks and the money market funds. I am not so naive to think that in a year or two I am going to be battling Fidelity and Putnam and causing them to lose any sleep at night.

On the other hand, if I can insure that my own institution can last another 2 or 3 years beyond what it might otherwise, simply because our raw material is being exhausted, I think it would be imprudent to take any other approach.

I have been told that it is a dangerous business to get into, and it is in some cases unprofitable. All I know is what I read in the papers. Where I see my depositors going. I will take my chances. I cannot insure that this is going to work or not work. I want the opportunity to try.

PUSHING THE LITTLE GUY OUT

The CHAIRMAN. My point is, you are dealing with those large concentrations in a lot of areas, anyway. In certain areas of competition, the big banks do dominate; there is no doubt about that. Most of the small banks in my State probably do not even understand what goes on in New York. They don't care. They are back serving little people with small accounts, doing a good job of it, taking care of their local needs—the agricultural bonds and so on. I have very difficult problems with bigness, period, whether it is the big banks, the big securities businesses, big government—pushing all of you little guys out, because they are not going to get back in, ever, to provide that kind of service, the kind of local service that I have been used to.

I agree with you, and I agree with Mr. Silver, sure, the majority of it is going to be concentrated there, but if we give the little guys some tools to survive, maybe we can still have a level of personal service that Sears or the big boys are never going to be interested

in giving. Where you can walk into a bank, and maybe they don't go through all of the numbers in the computer, and they give you a loan because they have known you for 30 years. They know that you will pay it back, even if it does not fit with their model in the computer that would deny them. That is basically what I am fighting for. Maybe it is because of my small State, rural background. I share your feeling about concentrations, but it extends beyond banks, to your industry and others. I don't know how some of the small securities industries, dealers, in your business are going to survive, either, because there is a concentration occurring there. Those are the ones I like to deal with at home as well. Though I have not had any money to invest since I have been in the Senate.

Mr. Van Liew or Mr. Garver, how do you respond to Mr. Cantor's argument that there is simply no reason why bank salesmen of investment company securities should not be subject to SEC regulations. Unless the banking entities desire to secure regulatory treatment different from that which they could obtain under the Securities Exchange Act?

Secretary Regan's proposal to require that securities activities be conducted through the bank holding company would make these activities subject to the Securities Exchange Act.

Mr. VAN LIEW. I will respond to the last part first, if I may. I personally feel that I would not like to see many banks who do not have holding companies frozen out. As I understood his testimony, he was saying that banks without a holding company structure cannot provide mutual fund products keeping many banks with very competent trust departments out of the business. So, I personally feel that any financial institution with the capability should be able to provide the public with mutual fund products.

The aspect of the SEC again, I agree in principle, as you said, with the idea that it makes sense for the level playing field. Therefore, all of us who are doing the same thing, should be looked at in the same way. However, we support your bill which puts a fund under the SEC and sales and training under the primary bank regulator.

The CHAIRMAN. Mr. Garver, do you have any comment?

Mr. GARVER. I would like to have one less regulator.

I am not certain of the competency of the FDIC to take on this kind of responsibility, but I would hope the FDIC would be able to monitor the practices and progress of banks which choose to undertake this activity, and therefore not subject us to yet one more regulator. Frankly, we have enough right now, Senator.

The CHAIRMAN. Mr. Cantor?

Mr. CANTOR. May I add, as I read the proposal, that it appears that the type and the extent of regulation in the broker dealer area that seems to be contemplated in the bill is in and of itself not as extensive or comprehensive as what the SEC regulation would be. You would almost be statutorily saying—you would be statutorily saying—that those in the banking business that sell securities are to be regulated by the banking authorities. But you would almost certainly be saying that they are not to be regulated to the same extent.

The CHAIRMAN. That may be true. And again, this legislation is a starting point for discussion. I have never yet seen any bill introduced in the Congress become law in exactly the form that it was introduced. There are obviously going to be a lot of changes. That is the purpose of holding hearings, to seek information before we ever get to a markup.

Mr. Garver, some spokesmen for thrift institutions believe that the ability to offer commingled agency accounts would be harmful to their operations. It would increase their costs. You have essentially answered that: You want to give it a try.

The representative of the National Association of Home Builders yesterday expressed concern that if thrifts use such authority, it would detract from the funds available for real estate lending. In fact, the testimony from the National Association of Realtors, as well as the Home Builders, opposes most of the provisions of S. 1720 because they felt if they were granted commercial lending authority and these other new authorities—commingled accounts—the money being used for mortgage lending would disappear. That was despite the fact that at the same table there were representatives of thrift industries who said no, they would still expect to put 60 percent to two-thirds of their assets into mortgage loans.

What is your feeling? Do you think these new powers would detract from mortgage lending?

NO MORTGAGE LENDING NOW

Mr. GARVER. There is no mortgage lending going on now. Two years ago, when we were in the mortgage market the last time in a big way, we were originating 1,000 loans a year, which would be a rate of about 20 a week. In the last couple of months, we have been running two, three, or four loans a week and on some of these, because of the movement of rates, by the time the closing comes, the home buyers cannot afford to close. So, the situation right now is that there is no money of any significance going into the home mortgage market and we all know why.

Second, I think the recent introduction of new types of variable rate mortgage instruments is broadening the market in terms of lenders. The insurance companies increasingly have been going into this arena, although recently they have begun to experience a cashflow problem, just as we do.

New mortgage banking firms are springing up, and clearly the secondary market is becoming, given lower interest rates, more active. I don't think that thrift institutions are going to have to bear the full burden in the future. In the present situation one can argue that you should not do anything which will take more money out of the home mortgage market, but I do believe, as interest rates come down, that there will be an expanded service group who will provide funding for this industry.

Third, from the standpoint of the thrift industry, I am not thrilled with the idea of trying to get into the money market fund business. I understand the risks; I wish I didn't have to do it. The fact is that home mortgage lending is where we have had our niche for 150 years as far as mutual savings banks and savings and loan associations are concerned. To throw that away would be very foolish, and we have no intention of doing it.

I do not know in 1985 whether I will have 60 percent of our assets in home mortgage loans or 40, but I will tell you this, it will be a continuing and significant part of my business, because I think the investment, as it is now constituted, is a good one. It is just that right now I do not have any money to put into it. If the money market fund offers me a chance to stabilize my operations, to increase my profits somewhat, to keep my depositors, I think in the long run it is beneficial to the home mortgage market.

The CHAIRMAN. So your point is simply that there is very little money going into home mortgages with the current difficulties. That unless you find some means of rejuvenating your business, you are not going to be making any mortgage loans because you will not be in business.

Mr. GARVER. Exactly.

The CHAIRMAN. Mr. Cantor, you said allowing banks to underwrite municipal revenue bonds—and I quote—“clearly contradicts the legislative intent of Glass-Steagall.” That puzzles me a little bit. When Glass-Steagall was passed, revenue bonds were simply not a material factor at all in the municipal securities market in 1933. I do not know that Congress at that time, in their legislative intent, could even be spelled out on that.

Mr. CANTOR. All I meant was that it would break down the delineation, the strict delineation, between investment banking and commercial banking functions.

Frankly, the life insurance industry is not addressing the propriety of underwriting these revenue bonds. What we are saying is that to do so would be a clear abrogation of the Glass-Seagall concept of keeping commercial banks out of the investment banking business.

The CHAIRMAN. Banks have always been able to write general obligation bonds. And looking at the practical side of it, wouldn't you agree that in many cases in today's market that revenue bonds are more secure than general obligation bonds of some cities, having the full faith and credit of the city taxpayers behind them?

Mr. CANTOR. I am not prepared to contest the issue, sir. As I say, we are not addressing that point. It was merely another facet of the question of whether Glass-Steagall would keep the wall up or not.

The CHAIRMAN. Mr. Silver, would you respond to that again, not the legal distinction—we recognize that exists—but from a practical standpoint in today's market, do you say municipal revenue bonds are much less secure than general obligation bonds?

Mr. SILVER. I guess the implication of your question is maybe nobody's full faith and credit can be relied upon these days.

I think I would agree with the thrust of Mr. Cantor's answer. Before relaxing the Glass-Seagall Act, I think that you have to be satisfied that the problems have been solved. And you indicated that perhaps the passage of time, technological developments, a different regulatory climate, may provide part of the answer.

I think you have to be satisfied that the concerns which gave rise to the Glass-Steagall Act have been cured, not simply that revenue bonds are like general obligation bonds, but that in order to change the presently existing boundary lines, that the public would be

adequately protected. Those are the questions I think that have to be looked at.

The CHAIRMAN. I don't mean to indicate that they have totally been cured. There is no fear at all. That's not what I'm talking about. I am saying that conditions are different. We ought to reevaluate Glass-Steagall and McFadden in terms of those changed conditions to determine where the new ball park is. I certainly do not say that they have all been cured, either in the commercial banking industry or in the securities industry. Certainly they have not, but we are dealing with a new set of conditions; and I think that we ought to review on the basis of those new conditions.

Mr. SILVER. I can wholly subscribe to that.

Mr. CANTOR. And I would say the same in the insurance business.

The CHAIRMAN. I may be back in competition with you in a few years, depending on how the people of Utah feel about me. One of the reasons I get the votes of the insurance industry at home is to keep me here so I won't come back and compete with them again.

There are also people who voted for me to get rid of me as mayor of Salt Lake City. As long as they got me out of town, they did not care where I went.

Senator Dixon, do you have any questions, comments?

These poor gentlemen have been totally subjected to me for an hour and a half without any break, and I apologize to them for that. Our colleagues are at so many different meetings this morning, I apologize that they were not here to give you a break from me.

Senator DIXON. I want the witnesses to know that I heard all of their testimony before it was necessary for me to leave for another meeting. Having just returned and knowing of the Chair's careful questioning of all of the witnesses, I am sure that anything I would ask would be repetitious. I simply want to thank the witnesses for their testimony and thank the Chair, and perhaps I will question the next panel.

The CHAIRMAN. Gentlemen, we appreciate your testimony very much, and I mean that sincerely. Let me just, in closing, state that I have no particular preconceived ideas on where we end up with the exact language. I want to reiterate how important it is to me to try to achieve some competitive equity.

As I asked the savings and loan witnesses and the ABA witnesses, I wish it would be possible to have some cooperation and all segments being willing to give a little bit. If everybody sticks to just their position, as elicited in their testimony, we will simply not have any changes—everybody says, "This is the way I want it"—we will end up with no legislation at all, and maybe that would benefit some.

I would hope at the end of this process, wherever it is—and it will be a long time down the road, beyond this particular legislation, getting into Glass-Steagall—I would hope we could have a little statesmanship. And don't misunderstand that statement. I have said the same thing to every witness. I see no possibility of achieving any type of consensus. We go on with the same types of polarization that is existing right now, while a very valuable part of the industry, the thrift industry, is in very, very great difficulty.

I thank you very much for your testimony.

The CHAIRMAN. If we could have the next panel come up.

STATEMENTS OF RALPH D. DeNUNZIO, CHAIRMAN OF THE BOARD, SECURITIES INDUSTRY ASSOCIATION; AND WALTER W. CRAIGIE, JR., CHAIRMAN, MUNICIPAL FINANCE COMMITTEE, SECURITIES INDUSTRY ASSOCIATION, ACCOMPANIED BY PROF. MICHAEL MUSSA, UNIVERSITY OF CHICAGO, PROF. GEORGE KAUFMAN, LOYOLA UNIVERSITY, AND EDWARD O'BRIEN, CHAIRMAN, SECURITIES INDUSTRY ASSOCIATION; HOWARD M. SCHNEIDER, PRESIDENT, DEALER BANK ASSOCIATION; AND EDWARD J. KREMER, MEMBER, INDEPENDENT INSURANCE AGENTS OF AMERICA, ACCOMPANIED BY TOM WILSON

The CHAIRMAN. We are happy to have you with us this morning. Mr. DeNunzio, if you would like to begin.

Mr. DeNUNZIO. Thank you, Mr. Chairman. We are happy to be here.

I would like to just introduce myself quickly. My name is Ralph DeNunzio, I am the president of Kitter-Peabody, chief executive officer, this year the chairman of the board of the Securities Industry Association.

With me are a number of my associates, Edward O'Brien, chairman of the Securities Industry Association, and Walter Craigie, president of the Municipal Finance Committee of the SIA.

With me, also, are two nationally recognized economists in the area of municipal finance. And I would like to introduce them to you, Prof. George Kaufman from Loyola University and Prof. Michael Mussa from the University of Chicago.

It is our intent to answer any questions that you may present to us.

Our association is pleased to appear before you to state its position as to the proper relationship between the securities industry and the commercial banking industry with respect to commercial bank underwriting of municipal revenue bonds.

At the outset, we want to restate the position of the SIA, that the Glass-Steagall Act has efficacy today in putting forth the national policy affecting the relationship between financial intermediaries. We appreciate the seriousness and the boldness of the chairman's initiatives put forward in this legislation and those recently proposed by the Secretary of the Treasury.

We pledge our support to examine these proposals and reexamine the entire Glass-Steagall Act. The act, now almost 50 years old, has stood the test of time, and it has helped to create for this country the most envied capital market system in the world.

There is, however, no question that technology, new ideas, new products, new demands from customers of all financial institutions are changing and will continue to do so.

It is for this reason that we believe the act should be reviewed in its entirety and new approaches such as the one put forth by Treasury Secretary Regan should be considered. But this review should take place in the entire context of the act, not in a piecemeal fashion, as suggested by S. 1720.

We could describe many major differences between commercial banks and investment bankers and broker-dealers which should be examined. We would welcome the debate and discussion which would be forthcoming on this issue.

In our view, this issue is so complex and so interwoven with the fabric of our capital market system that any piecemeal approach should be rejected.

OPPOSE COMMERCIAL BANKS UNDERWRITING BONDS

Now, we appreciate that our particular area of interest this morning concerns title III of S. 1720, and we reiterate our position in opposition to further entry of commercial banks into the underwriting of municipal revenue bonds.

There is today, as you know, an officially functioning market in the underwriting, sale, and distribution of municipal revenue bonds, coupled with a high level of competition. We believe that the further entry of commercial banks into the underwriting of revenue bonds will not reduce interest costs to issuers and will lead to the same conflicts of interest and financial concentrations of power that led to the enactment of the Glass-Steagall Act.

At this time, I would like to introduce to you and to the committee Mr. Walter Craigie, chairman of the SIA Municipal Committee, who will present our detailed testimony relating to title III of S. 1720.

Mr. CRAIGIE. Thank you, Mr. Chairman, members of this committee. I hope that you will forgive a bad cold, which I have today.

My name is Walter Craigie, Jr. I am executive vice president of Securities of Richmond, Va. In earlier days, I served as treasurer of the Commonwealth of Virginia. Overall, I have served 25 years in the area of public finance and have been involved in billions of dollars of financing in the municipal markets.

This year it is my honor to serve as chairman of the Municipal Finance Committee of the Securities Industry Association. Like many represented on my committee, my firm is a regional investment banking and brokerage house, concerned by the threat to our health and survival by commercial banks entering our business with their unique competitive advantages intact.

We commend the committee and you, Mr. Chairman, for your initiative in commencing this review of the needs of the financial marketplace.

We are here before you today to testify in opposition to the provisions of title III of S. 1720, which would amend the Glass-Steagall Act to permit commercial banks to underwrite all municipal revenue bonds without any change in their unique advantages.

We support your comprehensive review of the Glass-Steagall Act early next year and inclusion of this issue in that review. We also support the consideration of the proposal advanced on Monday by Secretary Regan with respect to revenue bond underwriting in that review as well.

We believe title III moves in the wrong direction, away from a level playing field. Why? Because commercial banks would be given a new field, while keeping their unique tax and other advantages.

We in the securities industry live by competition. We, too, believe in a level playing field. But what does that phrase mean? It means a place where competition is on the level, where players compete on even terms. It does not mean that all players are of equal strength or size. It does mean that all play by the same rules, with the same officials, and with no one having special advantages not available to all.

Our industry is open to all who play by the same rules that we do and who are subject to the same regulations. We welcome Prudential, American Express, and Sears to the securities business. Their affiliation with companies in our business will add zest, capital, and new incentives to competition we are sure. Their entry does not decrease competition but enhances it.

While we already have plenty of competition, there is always room for more, but on an equal footing. The Boston Marathon is still the same race as its numbers swell from hundreds to thousands. Why? Because all who enter do so on equal competitive terms.

Mr. Chairman, you have stated that there will be a broad review of Glass-Steagall beginning early next year. We hope and believe that such a review will confirm the desirability of preserving and indeed expanding an American financial marketplace, rich in diversity. We are confident that Congress, upon comprehensive review, will unequivocally reject the notion of a financial marketplace dominated by a dozen giant money center banks as being in the public interest of our country. Such a concentration of economic power must be avoided.

We suggest to you, Mr. Chairman, that not only revenue bond underwriting, but also the underwriting of general obligation bonds and government securities by commercial banks be included in that review.

The issues raised by title III to enlarge this exception are complex and cannot be properly dealt with in isolation. The consequences of error can be disastrous.

Title III of S. 1720 will provide no benefit to the municipalities as claimed by the Dealer Bank Association. Also, such a move might well cost the U.S. Treasury many millions of dollars.

These are the facts:

One, the large commercial banks claim hundreds of millions of dollars of savings to municipal issuers if they were allowed to underwrite all municipal revenue bonds. This claim is untrue and was disproven in 60 hours of hearings before the House Banking Committee—Subcommittee on Financial Institutions in 1979.

It is disturbing to see the DBA repeating their unsupportable claims. If the banks wish to provide real dollars to the public sector, they should surrender their special tax advantage of deducting the carrying costs of their tax exempt inventories. This should net the U.S. Treasury at least \$50 to \$100 million per year.

It is ironic that there are municipal governments to testify in support of commercial banks underwriting revenue bonds while they suffer from higher short-term borrowing costs, due to the all savers bonanza, which is estimated to benefit commercial banks in excess of \$5 billion. Professors Kaufman and Mussa are here to

answer questions with respect to these fallacious claims of savings, and their reports are a part of our written statement.

Unfair competition can destroy major segments of our industry. Particularly affected will be the smaller and regional broker dealers, which the joint study of the Securities and Exchange Committee and Small Business Administration indicates will be forced out of business, or to merge as a result of this type of change in Glass-Steagall. States, cities and towns, as well as small businesses everywhere in need of venture capital assistance, will be the losers from the demise of regional and smaller broker dealers.

As you are undoubtedly aware, Mr. Chairman, H.R. 4040 which is also filed in this session of Congress would permit commercial banks not only to underwrite all municipal revenue bonds, but to deal in corporate debt securities with other securities activities.

Three, if commercial banks are allowed to underwrite all municipal revenue bonds, the U.S. Treasury could well lose many millions of dollars. Banks will then be able to deduct from their taxable income their carrying costs on all municipal revenue bonds, something securities firms cannot do.

Four, this would concentrate more economic power in the dozen or so commercial banks that would be the principal beneficiaries. We in the securities business are proud of the job we are doing to help raise capital for municipal issuers, American businesses in these extraordinary times. The genius of the American financial system is its diversity. We do not have only one place to go for capital, as is the case in some countries such as Germany. If there is to be change, let it be done in a thoughtful and considered manner.

PROBLEMS OF CONFLICT OF INTEREST

The problems of conflict of interest and special tax advantages must be addressed. Any change must provide for the level playing field essential to fair competition. The secretary of the Treasury in his testimony on Monday advanced a fresh and innovative proposal. We are gratified that the secretary's proposal recognizes that the special bank advantages which they presently have can be destructive of competition outside of the field of banking.

We appreciate the seriousness of the secretary's attempt to maximize fair and efficient competition in the public securities marketplace for all who participate. The Secretary addresses a number of serious problems of competitive bank advantages and conflicts, but by no means all. We are not sure that the changes he suggests can or will result in a better or more competitive financial marketplace.

We agree that the Secretary's proposal should be thoroughly explored and developed. Is the administration's approach the right one? We do not know yet, but it may well be. We applaud Secretary Regan for advancing the proposal and pledge ourselves to work with him and this committee, Mr. Chairman, to search for a fair solution in the public interest.

But the primary question remains. Will a better financial marketplace result? Will State and local governments be better off? Will small, independent commercial banks benefit? What will be the impact on small and regional securities firms? Will small busi-

nesses venture capital opportunities and technological companies in need of capital have more or fewer places to go? Will the regulatory environment be simpler or more complex? Will the changes be worth it?

There exists no emergencies threatening the commercial banking system. There is time for careful capital consideration of this matter separate from the timetable which may be required to resolve problems confronting the thrift institutions. You have our pledge, Mr. Chairman, to maintain the vigorous competition that characterizes our industry today and to support any initiatives that will enhance fair and efficient competition across the entire spectrum of the financial services marketplace.

If Congress examines this intricate and complex situation with care, and considers thoughtfully the policy questions involved and the interests of State and local governments, and the citizens in business in America as well as legitimate interests of the commercial banks and the securities industry, we are sure that it will reach a solution which is in the public interest. The obvious context for this work is your comprehensive review of Glass-Steagall early next year, and we commit ourselves to working with you and the administration in an expeditious manner to develop a sound and fair setting for commercial bank and investment banker competition.

Mr. Chairman, I would be prepared later on to comment on the questions which you asked about smaller broker dealers' savings at a later date if you would want to do so. Thank you.

[Complete statement follows:]



REMARKS BY

WALTER W. CRAIGIE Jr.

CHAIRMAN

MUNICIPAL FINANCE COMMITTEE

SECURITIES INDUSTRY ASSOCIATION

Mr. Chairman and members of this distinguished Committee:

My name is Walter W. Craigie, Jr. I am Executive Vice President of Wheat First Securities of Richmond, Virginia. In earlier years I served as Treasurer of the Commonwealth of Virginia. Overall, I have spent more than 25 years in the area of public finance and have been involved in billions of dollars of financings in the municipal markets. This year it is my honor to serve as chairman of the Municipal Finance Committee of the Securities Industries Association ("SIA"). Like many represented on the Committee, my firm is a regional investment banking and brokerage house concerned by the threat to our health and survival by commercial banks' entering our business with their unique competitive advantages intact.

We commend the Committee, and you, Mr. Chairman, for commencing this review of the needs of the financial marketplace and appreciate very much the opportunity to present our views.

We are before you today to testify in opposition to the provisions of Title III of S.1720, which would amend the Glass-Steagall Act to permit commercial banks to underwrite all municipal revenue bonds without any change in their unique advantages. We support a comprehensive review of the Glass-Steagall Act and inclusion of this issue in that review. We also support the consideration of the proposal advanced on Monday by Secretary Regan with respect to revenue bond underwriting in that review as well.

We believe Title III moves in the wrong direction, away from a "level playing field." Let us explain why.

We in the securities industry live by competition. We too believe in a "level playing field." But what does that phrase mean? It means a place where competition is on the level, where players compete on even terms. It does not mean that all players are of equal strength or size, but it does mean that all play by the same rules, with the same officials, with no one having special advantages not available to all.

Our industry is open to all who play by the same rules that we do and who are subject to the same regulations. We welcome Prudential, American Express and Sears to the securities business. Their affiliation with companies in our business will add zest, capital and new incentives to competition, we are sure. Their entry does not decrease competition, but enhances it. While we already have plenty of competition, there is always room for more. But on an equal footing. The Boston Marathon is still the same race as its numbers swell from hundreds to thousands. Why? Because all who enter do so on equal competitive terms. Walter Wriston reportedly once said that perhaps Citicorp should spin off its domestic banking operations so it could pursue other financial goals. We say, "Fine, there is room for big competitors and small competitors, as long as they play with the same equipment." In short, no one is allowed in the Boston Marathon on roller skates. Not even Walter Wriston!

Broad Review of Glass-Steagall is Needed

Mr. Chairman, you have stated that there will be a broad review of Glass-Steagall beginning early next year. The SIA

welcomes such a review. We hope and believe that such a review will confirm the desirability of preserving and, indeed, expanding an American financial marketplace rich in diversity. We are confident that Congress, upon comprehensive review, will unequivocally reject the notion of a financial marketplace dominated by a dozen giant money center banks as being in the public interest of the country. Such a concentration of economic power must be avoided. We suggest to you, Mr. Chairman, that not only revenue bond underwriting but also the underwriting of general obligation bonds and government securities by commercial banks be included in that review. This activity is an exception to the Glass-Steagall separation of commercial banking and investment banking which we believe is no longer required. And it is carried on on terms unfair to us. The issues raised by Title III to enlarge this exception are complex and cannot be properly dealt with in isolation. The consequences of error can be disastrous as events culminating in the enactment of the Glass-Steagall Act remind us.

A Chapter From Banking History

"Those who cannot remember the past are condemned to repeat it", said the philosopher George Santayana. It is difficult, even a little disagreeable, to recall now the disasters of the 30's and the chain of events in the 20's which brought them about. Yet the effort must be made, for any reliable prediction of the future must be firmly rooted in the experience of the past. Indeed, had the commercial banks heeded warnings based on

past experience they would have recognized, long before 1929, the dangers inherent in their participation in the investment banking business.

As early as 1911, the Solicitor General of the United States had pointed out, "It is neither banking nor an incident of banking to invest the funds of the bank in another business, in any manner or to any extent."¹ In holding that the National City Company's operations violated federal and state law, he had stated that combining banking and non-banking functions in the same or affiliated organizations created the risk of involving all of them "in a common disaster," and that, even if successful, such combination "would mean a union of power in the same hands over industry, commerce and finance with a resulting power over public affairs" which would clearly be against the public interest.²

In 1913, after extensive hearings, the House Committee on Banking and Currency, the Pujo Committee, had specifically emphasized the desirability of divorcing investment banking from commercial banking.³ And in 1920 the Comptroller of the Currency had cautioned: "The business of legitimate banking is entirely separate and distinct from the kind of business conducted by many of the 'securities corporations,' and it would be difficult, if not impossible, for the same set of officers to conduct safely, soundly, and successfully the conservative business of the national bank and at the same time direct and manage the speculative ventures and promotions of the ancillary institutions."⁴

The large commercial banks did not listen. The interest of the many in having fundamentally sound and well regulated banking was flouted in favor of the short-run private advantage to a few. The temptations were too great. Closing their eyes to the conflicts of interest and yielding to the temptations to speculation about which they had been warned, these banks, with their vast capital, achieved a meteoric rise to dominance in investment banking. As Judge Harold R. Medina observed in the landmark opinion that has become the definitive text on investment banking (United States v. Morgan, 228 F.Supp. 621,644-645:

"...The economic power of these huge aggregations of capital vis-a-vis the relatively small capital of issuers was a factor of no mean significance in the period just before the great depression. There was an additional leverage in the multiplicity of banking functions which could be placed at the disposal of issuers. Added to this was the vast influence and prestige which must have made itself felt in a variety of ways. Issuers were dependent upon these great banking institutions in a way which finds no parallel in the relations between issuers and investment bankers in the period subsequent to the passage of the Banking and Securities Acts....

* * * *

"...[T]hese great banking institutions and their affiliates were doing a huge investment banking business, and they were using the money of their depositors as well as their own resources to underwrite one security issue after another."

This unique power and prestige were exploited in every possible way to squeeze out investment banking competition. By abusing their legitimate fiduciary functions of lending and investing "other peoples' money" such banks were in an unequalled position to build up their underwriting activities, which in turn contributed new customers for their commercial banking and trust

department services.⁵ Not many who could possibly be customers of either the banks or their securities affiliates were overlooked. For example, lists of depositors and stockholders were made available to the securities affiliates.⁶ These prospects, when subjected to high pressure sales methods, proved a fruitful source of new business to the affiliates.⁷ Employees of the banks proved another such source.⁸ And, taking advantage of a correspondent banking system that even today provides the same opportunities for abuse by a bank which is also a securities underwriter, many of these financial giants used the small country banks that trusted them for investment advice as "a good dumping ground for second or third grade securities."⁹ Senator Brookhardt noted that these securities had "depreciated so much that they closed several thousand banks."¹⁰

By 1929 such tactics had enabled certain great commercial banks to reach the pinnacle of their power and influence over the capital markets of the nation. A statement submitted by J.P. Morgan & Co. in 1932 to the Senate Banking and Currency Committee spoke no more than the sober truth:

"The great commercial banks, directly or through their affiliates, have in the past 20 years or thereabouts to a large extent occupied the field of capital issues, purchased and absorbed some private issuing and distributing houses and by their competition driven others out of business or restricted their opportunity for profit and therefore their resources."¹¹

Figures submitted to the Senate Committee in February 1931 by Charles E. Mitchell, then President and Chairman of the Board of both the National City Bank and the National City Co., revealed that, in the four-year period from 1927 through 1930,

the originations of new issues by all banks - national banks, commercial banks, trust companies, and various bank affiliates - had increased from 22% of total originations in 1927 to 44.6% in 1930. The share of private bankers, i.e., investment bankers, had decreased correspondingly from 78% of total originations in 1927 to 55.4% in 1930. Similarly, the banks and allied institutions had increased their share in participations from 36.8% in 1927 to 61.2% in 1930, while that of the investment bankers had decreased correspondingly from 63.2% in 1927 to 38.8% in 1930.

Moreover, this growth in underwriting size and power had become increasingly concentrated in the securities affiliates of the relatively few banks that were actively interested in the securities business. While commercial banks on the whole were approximately doubling their share, these affiliates nearly tripled their total share of the securities business during this period, from 12.8% of originations in 1927 to 39.2% in 1930, from 20.6% of participations in 1927 to 54.4% in 1930.¹²

When the depression struck, however, such banks and their underwriting affiliates suffered a dramatic and tragic reversal of fortune, particularly tragic for the hundreds of thousands of people who had entrusted their money to them. Even the banks came to recognize, if only temporarily, that the very combination of commercial and investment banking functions that had enabled them to dominate American finance was to a great extent responsible for their enfeebled financial condition, and certainly for that of their depositors and the investing public at large.

The hearings held by the Senate Banking and Currency Committee from 1931 to 1934 disclosed example after example of shockingly reckless and dangerous banking practices engendered by the widespread activities of certain banks through their securities affiliates, in both the underwriting and distribution of securities, and also demonstrated how directly these activities had imperiled the position and soundness of many of the banks concerned. These hearings left no doubt that the primary banking functions of serving as a depository, as a trustee, as an investor of deposited funds, and as a lender, all could be and often had been abused by some banks that also sought to engage in the underwriting and distribution of security issues.

When certain securities affiliates had tottered on the brink of ruin as a result of the remorseless deflation which began in 1929, the parent banks, naturally fearing that the failure of the affiliate would irreparably damage the bank's own credit and standing, felt forced to go to their aid with financial assistance in the form of either loans to the affiliate or purchases from the affiliate's inventory of unsalable or greatly depreciated securities. The loans in many cases were excessive or were secured by inadequate collateral and subsequently entailed huge losses.¹³ Instances also came to light during the hearings of trust accounts which had been loaded with unsound securities, some of them partially in default. Such securities had been purchased from the bank or trust company's affiliate, often at a handsome profit to the affiliate, a gross violation of the fiduciary relationship.¹⁴

The collapse of a number of major banks demonstrated how their involvement in the business of investment banking had played a significant part in undermining their financial position; individual bank losses in connection with such activities were measured in the tens of millions or more.¹⁵

The magnitude of the individual and institutional disasters caused, at least in part, by the involvement of banks in the securities business made Senator Carter Glass exclaim, in the course of the hearings, "The public cannot conceive of the harm done by these affiliates."¹⁶ The enactment of the Glass-Steagall Act, and the preservation of its guiding principles against attack, was the response of Congress to this sorry record. The then President and Chairman of the Board of the Chase National Bank, Winthrop W. Aldrich, a distinguished banker and lawyer and subsequently Ambassador to Great Britain, said in a statement submitted to the Senate Banking and Currency Committee in November, 1933:

"[My] experience as a bank official, coupled with the testimony which was presented to your committee in February of this year had convinced me that many of the abuses in the banking situation had arisen from failure to discern that commercial banking and investment banking are two fields of activity essentially different in nature. I came to believe that while it was essential that there should be coordination between these two types of banking, such coordination could best be protected from abuse and thus enhanced in usefulness through absolute separation of interest between the two fields....

* * * *

"The system itself which permitted overlapping of function and interlocking of interest between these two types of banking has been responsible for much that the public now condemns."

Mr. Aldrich emphasized: "The commercial bank's credit function is very definitely governed by its responsibility to meet its deposit liabilities on demand. It must not seek excessive profits by taking undue credit risks and it cannot wisely tie up its funds in long-term credits however safe they may be." On the other hand, he pointed out, when long term credit is required, the services of the investment banker are needed to "take speculative risks of a sort unsuitable to the commercial bank in providing capital funds for new and promising enterprises." With every new issue the investment banker "takes the risk that the public may not readily absorb the new securities which he brings out and that his own capital may be tied up for a long time."

The Glass-Steagall Act was praised by Mr. Aldrich not only for preventing the banks from undertaking risks that they could not and should not assume but also for eliminating the possibilities of abuse inherent in a union of the underwriting and commercial banking functions. The commercial banks, he maintained, "should not be in a position to exert any pressure whatever arising out of a dual financial interest." He specifically recognized that it was inconsistent with the bank's duties as lender, as trustee, as depository and as adviser to its customers for it also to engage in the securities business. By way of illustration, he said:

"It is perfectly proper, for example, that commercial banks should lend to investment bankers, on short term, funds necessary to carry a new issue of securities while it is in the process of being marketed. Such a loan, always secured by collateral and carefully scrutinized by the commercial bank, performs an essential service.

The commercial bank or banks making such a loan, however, should be absolutely free from interest in the issue, and immunized from possible influence arising from interlocking interests with the investment bankers participating in it."

Mr. Aldrich concluded:

"In considering legislation aimed at prohibiting practices contrary to the public interest, it is impossible to draw a distinction between the careful and conscientious banker who would never consciously permit his influence to be misused or his allegiance to be divided, and the banker who, through recklessness or even because of his private interest, might exercise his influence improperly, if opportunity is permitted to exist.

* * * *

"The wisdom of effecting a clear differentiation of function and separation in interest between commercial banking and investment banking was recognized in the Glass-Steagall Bill, passed last June and now known as the Banking Act of 1933. The history of that Act and its general provisions indicate a clear intent on the part of Congress to effect, once and for all, a complete separation between commercial banks and investment bankers."¹

The Glass-Steagall Act, passed in 1933, removed all but limited securities activities from the reach of the commercial banks, in explicit recognition that such concentration of economic power in banks had precipitated and exacerbated the crash and subsequent depression. Accordingly, an independent, responsive, professional, nation-wide broker/dealer community, severed from bank affiliation by the Glass-Steagall Act, emerged and grew, developing competitively under the rigorous demands of private citizens, government and business. The United States broker/dealer community, overseen by one of the federal government's most watchful and effective regulatory agencies, the Securities and Exchange Commission ("SEC") services our nation's

securities needs in the most efficient capital market in the world. One might ask why we should tinker with this highly complex system, essential to our economic well being, when by all standards it is currently functioning very well.

No Savings to Tax-Exempt Issuers

Much has been said about alleged savings to be gained by tax exempt issuers if commercial banks were allowed to underwrite all revenue bonds. However, there is no evidence whatsoever of such savings. The Dealer Bank Association ("DBA") commissioned a study by Professor Phillip Cagan that reported savings from underwriting by commercial banks totalling more than \$400 million in 1977 alone. This comes to approximately \$25 per bank- ineligible bond. Because these savings were astonishingly large, the SIA requested the Center for Capital Market Research at the University of Oregon to review the Cagan study. It found three serious errors in the empirical parts of the study:

1. The bank eligibility status of 25 percent of the bonds was incorrectly classified according to an independent bond counsel, Wood and Dawson of New York City;
2. The study failed to control for important characteristics of the bonds, in particular, the purpose of which the bonds were issued, information which the market uses to determine credit quality; and
3. The study assumed that permitting commercial banks to underwrite municipal revenue bonds would encourage state and local issuers to sell more bonds by competitive bid rather than

by negotiation, when the only study in this area conducted by the Municipal Finance Officers Association in Pennsylvania shows that, given a choice, municipal officials tend to choose negotiation whether or not commercial banks can participate.

After the classification errors are corrected and the econometric model is expanded to include the purposes for which the bonds were issued, the Oregon study finds that Cagan's own sample of bonds sold between 1973 and 1976 shows no statistically significant difference in interest costs between otherwise comparable bank eligible and ineligible bonds.

But these results possibly might have been unique to the 1973-77 period analyzed. Thus, we commissioned a second study by Professor George Kaufman and his colleagues at the University of Oregon Center for Capital Market Research to examine the data for 1979. The results are startling. If Cagan's own model without bond purpose is used, bank eligible bonds had a higher interest cost than otherwise comparable bank ineligible bonds. This result would please us, but if the expanded model that includes bond purpose is used, the difference in interest costs disappears. So we are not here arguing, as much as we might like to, that bank participation costs issuers money. It is clear that comparable bank eligible and bank ineligible bonds sell at statistically indistinguishable interest rates. These two studies have been made available to all, including government agencies, and, to the best of our knowledge, no one has found any errors either in the statistical analyses or in the conclusions.

Notwithstanding these two devastating studies, the DBA in its oral testimony before this committee on May 14, 1981, claimed \$100-200 million in savings; its accompanying written statement claimed \$150-300 million. No mention was made of the discredited Cagan study as a support for these claims. This study was conveniently ignored and a survey prepared by Professor William Silber of New York University was apparently the basis for the new DBA claims. This survey contained no independent work but canvassed a number of studies done by others. Both Dr. Kaufman, now Professor of Economics and Finance at the Loyola University of Chicago and Dr. Michael Mussa, Professor of Economics, Graduate School of Business, University of Chicago, have analyzed the Silber survey and found the survey defective and inaccurate, providing no basis for savings claims by the DBA or anyone else. Reports by both Dr. Kaufman and Dr. Mussa are a part of this statement as appendices I and II respectively.

We also request that an earlier study done by Professor Mussa in January 1979 on competition and borrowing in the revenue bond market also be included in the record at this point and that Dr. Kaufman's two earlier studies while at Oregon be inserted into the record as well.

We are prepared, Mr. Chairman, on any occasion that the Committee desires to testify at length and in detail about the issue of interest savings until all are satisfied beyond reasonable doubt that an expansion of bank underwriting authority will not produce savings for bond issuers.

Further, the major money costs and tax advantages which banks enjoy over broker-dealers (which are discussed in detail later) mean a lower cost of doing business for the banks in the tax-exempt area. If the profits and revenues from these special bank benefits were fully passed on to municipalities, commercial banks should be able to outbid securities firms 100% of the time in the general obligation market now, not just 50% of the time. The differential in the cost of doing business is obviously retained by the banks as profits. Because of a bank's lower cost of money and tax advantages, a bank underwriter may choose either to take higher profits, while permitting existence to its non-bank competitors, or to take lower profits while pricing them out of business. If the savings from such advantages have not been passed on in the general obligation market, why should one anticipate the commercial banks would pass them on in the revenue bond market?

No Increase In Liquidity As Claimed

Since their savings claims appear to have no basis in fact, banks recently have been arguing that their entry into the revenue bond business would increase the liquidity of both the primary and secondary markets since they would apparently increase their inventories of revenue bonds. This argument also lacks merit as commercial banks today are no longer net buyers for their investment portfolios. Despite their professed concern for public issuers, it is clear that the banks are sheltering

taxable income through activities such as leasing and by giving preference to the higher-yield tax-exempt securities (IDB's) issued for the benefit of their private customers (with their checking accounts and compensating balances). Consequently, there is little or no room left to respond to the borrowing requirements of the states, cities and towns in their loan and investment portfolios. . So where is the increase in liquidity?

The U.S. Treasury Will Lose Revenue From This Bill

The commercial banks now herald bank underwriting of revenue bonds as something Congress can do for state and local governments in these most difficult times at no cost to the U.S. Treasury. (We wonder if they made the same assertion when they sought the benefit of the All-Savers legislation; municipalities are hurt by All-Savers while the commercial banks profit with no discernible public benefit.) As mentioned, banks deduct the interest costs of carrying their tax-exempt inventories from their taxable income. How many millions, or tens of millions if not hundreds of millions, will the Treasury lose if those tax-exempt inventories are substantially expanded with revenue bonds? Perhaps the banks can tell us. The cost probably will not match the \$5 to \$10 billion loss attributable to the expected commercial banks' share of All-Savers certificates, but the All-Savers cost may be only a one time loss, whereas the loss of revenue from expanded inventories would be continuing. The banks can argue there will be no such added loss to the Treasury only if they expect their tax-exempt inventories not to expand. This

position is completely inconsistent with their greater liquidity argument. The banks cannot have it both ways. Either there will be bigger inventories at added cost to the Treasury or the increased liquidity argument fails.

Conflicts of Interest

The important policy considerations militating against bank underwriting of revenue bonds are the same as those which led to the enactment of the Glass-Steagall Act separating commercial from investment banking. The simple fact is that many banking functions, particularly those relating to a bank's role as an investor in municipal securities and trustee for fiduciary accounts, plus the obligations owed to depositors and shareholders, cannot be combined with the business of underwriting and distributing securities without creating serious conflicts of interest no amount of law and regulation can eliminate or even adequately control. The discussion on tie-ins later in this statement also illustrates this point.

The Bank as Underwriter and Investor. It is important to understand the distinction between a bank as underwriter and investor in municipal securities. Virtually all banks commit a portion of their assets to the purchase of tax-exempt municipal securities and historically 40 to 50 percent of total outstanding municipal securities, both general obligation and revenue bonds, have been held for investment by commercial banks. (It is lower today as banks are favoring other tax shelters and the

higher yielding industrial development bonds issued on behalf of their private customers. Approximately 160 banks also act to some degree as underwriters of eligible municipal securities, principally general obligation bonds, with about a dozen or so large financial center banks dominating this area of bank activity. Dealer banks, i.e., those that engage in underwriting, maintain separate accounts for the separate and different functions designated as underwriting account and investment or portfolio account.

It will hardly be denied that the investment securities bought by a bank should be carefully chosen because of their intrinsic worth and because their acquisition furthers the objective of maintaining a properly balanced and diversified investment portfolio. Bonds - particularly long-term obligations - ought not to be selected for the investment portfolio merely because they have been acquired by the underwriting or trading department in the course of its day-to-day operations. Yet, data obtained from the banks by the Senate Antitrust and Monopoly Subcommittee covering the years 1969-1971 reveals there is a close relationship between the activities of the dealer banks' underwriting and portfolio accounts. The portfolio accounts showed disproportionately high holdings of bonds the bank has underwritten. One dealer bank made no purchases of issues for investment on which it had bid unsuccessfully, and made no purchases for its own investment account except from syndicates of which it was a manager. As a consequence there were no

revenue bonds in portfolio. During the three-year period studied, an average of 64.1% of investments in new issue general obligation bonds by the 20 leading underwriting banks were purchased from the banks' own syndicates. It appears that a principal interest of these banks in underwriting municipal securities is to obtain bonds for investment at the underwriting discount.

The combining of the underwriting and investment roles allows the banks to use their investment portfolio to support their underwriting accounts, particularly with respect to slow moving issues. S.1720 (Title III) recognizes the problem and attempts to deal with it by prohibiting a dealer bank from purchasing bonds for investment from its underwriting account during the underwriting period. However, such purchases are permitted from the underwriting syndicate or a member thereof. Thus, dealer banks would remain free to purchase during the underwriting period either from the syndicate or from other dealer bank members thereof. A policy, however, under which purchases of securities underwritten by a bank are made for its investment portfolio only in the open market after termination of the underwriting syndicate does not avoid other possible conflicts of interest and prejudice to the bank as investor. In those instances where the security underwritten by the bank has been initially priced attractively and the underwritten securities have gone to a premium in the market, a prohibition against initial purchase for investment by the bank may penalize it as an investor.

The recent mid 1970's York City financial crisis illustrates the conflict of interest inherent in the dual role of banks as large investors and underwriters of municipal securities. The relevant staff report of the SEC describes how the large New York City banks during the period October 1974 to April 1975 were selling massive amounts of new issue of New York City debt to other correspondent banks and other purchasers at the same time they were reducing or eliminating their own investments therein. In their role as underwriters, the banks owed the issuer, New York City, the obligation to purchase and resell its securities on the most favorable terms as regards interest costs. As investors, the banks had an obligation to depositors and shareholders to reduce or liquidate questionable City assets, which they did. Unfortunately, however, this further exacerbated the City's financial plight by glutting the market with the City's debt, thereby driving up interest rates on the new debt being sold. Commenting on the problem described, the SEC staff report states:

"The underwriters were subject to intense pressure by City officials to underwrite and market securities. They recognized the immediate and catastrophic consequences of the failure to continue to market City securities to the public, and the fact that full disclosure would have eliminated this market. In March of 1975, the underwriters had large investments in City bonds and notes exceeding \$1 billion, or 20% of their combined equity. Thus, impairment of the market for the City's securities would have seriously affected the banks.

The conduct and role of the underwriters raise the question of whether changes should be made in the process of conducting municipal securities offerings in the future, to assure that the underwriters are sufficiently independent and that their paramount concern will be their responsibilities to the investing public."

The Bank as Underwriter and Trustee. Trust account purchases of municipal bonds are appropriate and desirable for many beneficiaries. The conflict of interest problem is obvious, however, when the trust department is part of an underwriting bank. That considerable interaction exists between underwriting banks and their affiliated trust departments was revealed by a 1972 Senate Antitrust Subcommittee questionnaire directed to the large dealer banks. The resulting data compiled showed that almost 25% of the fiduciary account purchases of general obligation bonds by the ten largest underwriting banks came from those banks themselves or from syndicates in which they were participating. S.1720 attempts to meet this conflict problem by imposing certain limitations on transactions between banks and their trust departments. The inefficacy of these limitations and the other so-called "safeguards" against conflicts of interest are fully analyzed in Appendix A.

Limiting trust account purchases of securities underwritten by a bank to those made only in the open market, after the syndicate has been terminated (a provision in S.1720), may not even avoid a conflict of interest. Where the offering has been unsuccessful and the syndicate has been terminated before all bonds have been sold, any purchases made for a trust account necessarily have the effect of supporting the market and so of helping the bank to dispose of its unsold participation at a more favorable price.

On the other hand, where the underwriting has been successful, and especially where the bonds are initially priced very attractively, conflict of interest is avoided only at the expense of placing the bank's trust accounts at an investment disadvantage. The underwritten securities cannot be obtained for the trust account at the initial public offering price, but only at such higher price as they may command in the post-offering market. The conclusion is inescapable that a bank which has a trust department and also underwrites security issues cannot avoid subjecting its trust accounts either to the dangers of self-dealing or to unwarranted investment penalties.

Banks Have Special Advantages Over All Competitors

Any contest between a bank and a non-bank is inherently anticompetitive. A bank's special advantages - provided to them in their role as banks - are unfair and destructive of effective competition when used outside the field of banking. This fact of life has been recognized by the National Banking Act of 1864, the Glass-Steagall Act and the Bank Holding Company Act, all of which confine the range of commercial banking activity.

The key difference between a bank and any competitor is a bank's ability to take deposits to use in its own business - federally insured deposits at that - resulting in readily available and inevitably lower cost capital for all of its endeavors. Not only securities firms, but grocery stores, newspapers, manufacturers and all other businesses, would fear head-to-head competition with a commercial bank with its lower cost of capital and access to federally insured deposits.

In addition, in a contest between a bank and a securities firm, a bank has special tax advantages. It also has captive markets such as its trust accounts, its own investment portfolio and its correspondent banks. As a major source of credit it wields economic power that a securities firm cannot match. Such imbalance in advantages is a block to "free competition" between a bank and a securities firm; under existing conditions, there can be no such thing. If the sphere of unfair competition is extended as is proposed in Title III of S.1720, the slide to bank domination of all of our nation's financial markets and the concentration of economic power in fewer and fewer hands will be sharply accelerated.

Commercial Banks Have Readily Available, Lower Cost, Capital

What is so special about a commercial bank that makes its presence in the securities market inherently unfair and anticompetitive? First, banks can take federally insured deposits from the public and use that money in the full range of their own businesses. Securities firms cannot do this.

Commercial banks thus enjoy from the outset a lower cost of capital, currently enhanced by Regulation Q and All-Savers certificates, that provides a unique advantage. In times of tight credit a bank's access to money for its own activities is particularly important. Securities firms do not have that advantage.

Commercial banks have access to Federal funds and the Federal Reserve discount window, advantages that also contribute

to their lower cost of capital. Securities firms do not have such access.

Even without Regulation Q commercial banks will maintain their advantage in availability of funds and cost of capital. The securities firms will still have to turn to the banks for their needed funds, because of the banks' ability to take deposits and their unique access to other sources of funds.

Tax Advantages

While the deductibility of the carrying costs of municipal bond inventories is the principal tax advantage for commercial banks, it is not the only one. These advantages are described in Appendix B: the ability to gain tax advantages from the partial worthlessness of securities; a more favorable loan loss reserve calculation method, and, of course, All-Savers. (Their inclusion in the All-Savers legislation takes much of the benefit away from the suffering thrift institutions, of course.) Each of these advantages gives the commercial bank an edge over the non-bank underwriter. Most certainly, these were not intended to provide a special benefit to banks in their competition with non-bank underwriters, but such is the result. These unfair disparities must be eliminated from the present area of bank and non-bank underwriting competition.

Captive Markets

Banks have their captive markets, which are another advantage. If an underwriting does not go as hoped, is there not a

temptation to fill trust accounts and correspondent accounts with the potential losers? And what about the temptation to put the winners in the bank's own investment portfolio? Why not? The carrying costs of that inventory are tax deductible but the income is real and non-taxable. Such advantages come replete with ~~conflicts-of-interest~~. (See the conflicts discussion earlier in this statement.) The inadequacy of the so-called "safeguards" against self-dealing in S.1720, Title III, are thoroughly analyzed in Appendix A.

Tie Ins

Banks in the underwriting of bank-eligible municipal bonds have the advantages of tie-ins which also contribute to unfair competition. A bank, as an inducement or a threat, can offer credit facilities - short term debt, lines of credit, letters of credit - to gain entry into a managing underwriting group. Non-bank underwriters cannot do this. Packaging of banking and underwriting services has caused non-bank underwriters to be forced out of management groups already in place. This is a major competitive problem today. Questions of conflict of interest are also raised by these practices. The SIA has protested the use of these tie-ins to the Comptroller of the Currency in a letter dated March 27, 1981, a copy of which is Appendix C to this statement.

We believe that the multiple roles of a bank in these situations - providing key banking services and acting as a member of the managing underwriter group - raise serious

questions involving conflict of interests and unfair practices, to say nothing of unsound banking practice. An example may be helpful in an understanding of this problem.

In a \$150 million underwriting of housing bonds in Florida, a large national bank, for a fee estimated to be in excess of \$20 million, provided a letter of credit to back a "put" of the bonds, for substantially the full amount of the bonds; it had the right to invest all bond proceeds and reserves under an investment agreement; and it acted as a managing underwriter. (In contrast, the total underwriters' discount in this bond issue was \$3.75 million.)

Each of the roles performed by the participant bank gives rise to a distinct set of interests. Conflicts between the bank's interests in one role and its interests in another role could impair the bank's judgment as to important duties and create the perception of divided loyalties. Does a bank, acting as a managing underwriter with the potential of obtaining very large fees for providing a letter of credit, have an improper promotional stake in bringing issues to market?

The problems of conflict are real: Because of the bank's interests under the letter of credit, it has a disincentive to work with the issuer to produce the best available interest rates for its bonds: the lower the interest rates the greater the chance there will be a call on the letter of credit.

In negotiating the allocation of the letter of credit fee among bond proceeds, mortgage and investment revenues and excess funds, the interests of the bank providing the letter of credit

Commercial banks are powerful and possess "clout"; as an issuer develops dependency on a bank to meet short-term financial needs the line of least resistance is to succumb to requests of the bank for underwriting relationships - and even to support of revenue bond underwriting. Many state and local government officials find that, under certain market conditions, they have no alternative but to include their commercial bank, with whom they have short-term loans, as managing underwriters of their permanent bond financings.

Existing Bank Participation in Securities Markets is Not Needed

Commercial banks are already in the securities business - underwriting general obligation bonds and certain revenue bonds and government obligations. This limited commercial bank participation in the securities business is really an historic anomaly. It was an exception to the blanket prohibition from investment banking activity - a squiggle in the Glass-Steagall line - because the securities industry in 1933 was just beginning the separate and independent life ordained by the legislation and there was concern for the market for general obligation and government bonds. Piecemeal expansions of the exception have occurred from time to time since. If the line is to be redrawn today, no such exception is necessary because we now have a mature securities industry capable of serving these markets efficiently. And, as stated, the existing competition of commercial banks - with their capital, tax and captive market and other advantages - is already inherently unfair. The elimination

banks which are capable of providing a letter of credit is imposing. The results could include unfair pricing of the fee as well as a linkage of unwanted services, such as underwriting and an investment contract, to the highly-desired letter of credit.

Finally, playing multiple roles gives the very large banks an opportunity to vary the level of compensation for each individual service to foreclose competition because of the enormous leverage it gains from providing a letter of credit. Each of the services could be provided separately just as efficiently. If, however, a bank were assured of selection for the letter of credit role, it could also assure itself of the investment contract position by reducing its required compensation for the investment contract while increasing the letter of credit commission. It could do the same with respect to the managing underwriter fees. The potential for such manipulation is inescapable where the banks offer these discrete services as a package or where providing one service (i.e., the letter of credit) is conditioned upon getting the other business.

The problem of tie-ins must be dealt with.

Multiple Relationships

A bank oftentimes seeks to be an all-service facility to tax-exempt issuers. It becomes its depository, its short-term lender, its bond trustee, its paying agent and purchaser of its bonds for its own account and for its trust accounts. Not only do conflict of interest problems arise from these relationships, but also the crowding out of underwriting competitors.

Commercial banks are powerful and possess "clout"; as an issuer develops dependency on a bank to meet short-term financial needs the line of least resistance is to succumb to requests of the bank for underwriting relationships - and even to support of revenue bond underwriting. Many state and local government officials find that, under certain market conditions, they have no alternative but to include their commercial bank, with whom they have short-term loans, as managing underwriters of their permanent bond financings.

Existing Bank Participation in Securities Markets is Not Needed

Commercial banks are already in the securities business - underwriting general obligation bonds and certain revenue bonds and government obligations. This limited commercial bank participation in the securities business is really an historic anomaly. It was an exception to the blanket prohibition from investment banking activity - a squiggle in the Glass-Steagall line - because the securities industry in 1933 was just beginning the separate and independent life ordained by the legislation and there was concern for the market for general obligation and government bonds. Piecemeal expansions of the exception have occurred from time to time since. If the line is to be redrawn today, no such exception is necessary because we now have a mature securities industry capable of serving these markets efficiently. And, as stated, the existing competition of commercial banks - with their capital, tax and captive market and other advantages - is already inherently unfair. The elimination

of those special advantages in our existing attempts to compete with banks, is, we believe, essential to insure a fair and efficient system of financial markets, if they are to continue to be in the securities business to any extent.

Regional and Smaller Securities Firms Lose

But commercial banks are not satisfied with their current inroads and special advantages. They always have evidenced a relentless desire to move further and further into our business with their special advantages intact. Their ambitions do not end with revenue bond underwriting. While today it is revenue bonds and mutual funds, tomorrow they want corporate debt securities and, ultimately, equities. We are sure you are aware, Mr. Chairman, of H.R.4040, which spells out those desires. If those cravings are satisfied, without fundamental alteration of the banks' statutorily-conferred advantages, the alternative capital formation opportunities in the United States as we know them today will cease to exist.

As the arena of unfair competition expands, regional and small investment bankers will be particularly threatened and significant numbers will be forced to merge or go out of business. Local jobs and revenues will be inevitably lost and power shifted to the major financial center banks. A joint study of the SEC and the Small Business Administration just completed supports this conclusion. As the SEC/SBA study forecasts, the principal losers in the securities business will be the small and regional broker-dealers who are important not only for the

smaller municipalities in many parts of this country but also for the capital raising needs of businesses, particularly small businesses, (e.g., for high technology and venture capital) throughout America.

Only Big Banks To Benefit

Who will benefit from the proposed changes set forth in Title III? The Dealer Bank Association, composed of 160 or so of the nation's most powerful commercial banks - out of 14,000 - want this legislation. They have fought for it year in and year out. They - and they alone - will really benefit. If you scrutinize the present industry activity of these banks, it will be clear that the largest dozen or so money center banks in this country will be the principal beneficiaries of Title III.

Some may believe municipal issuers will benefit and it is understandable that many issuers support the proposal. Our response is to call to their attention and to the Committee the testimony of former Governor C. Canby Balderston of the Federal Reserve Board testifying in the House in 1965:

"I can appreciate the feeling of some public finance officers about this bill [authorizing banks to underwrite revenue bonds]. From their point of view, enactment of such a bill might yield some benefit; if not, nothing would be lost. To them, even a relatively insignificant saving of interest cost, if one materialized, would be welcome. They naturally feel that the passage of such a law might yield some benefits to them and, in any event, would do them no harm.

"But in evaluating the proposal, this committee and the Congress must of course take a broader view, and balance the risk of conflicts of interest against the possible

gains from lower borrowing costs for public bodies. If the participation of commercial banks in securities underwriting posed a substantial threat to the effective performance of their banking functions and yet offered substantial benefits in the financing of State and municipalities, then your committee would face a real challenge in balancing the relative importance of the two factors to the general public. But in our judgment, no such problem is presented here. The danger of conflicts of interest is real and substantial, whereas the promise of cost benefits in public financing is remote and insubstantial." Hearings on H.R. 7539, Committee on Banking and Currency, 89th Congress, First Session." (Emphasis supplied.)

Freedom of Choice Will Be Eliminated in U.S. Financial Markets

The present financial system, aided and abetted in no small part by the Glass-Steagall Act, has encouraged alternative credit and investment opportunities to flourish on a scale unparalleled in our nation's history. This diversity is fully in keeping with the American spirit and in the best interest of our citizens. What to one person may be "one-stop banking," to another may be "only one place to go," or, even, "no place to go."

America will not be better off with a financial marketplace dominated by large banks exercising much greater concentrations of power and control over economic resources as is the case now in Europe. Make no mistake, Title III of S.1720 clearly takes a significant step in that direction. It will result in a substantial increase in big bank power within the financial marketplace. A gaping hole will be opened in the Glass-Steagall wall for the big commercial banks to roll through with all of their unique weapons in place. It will mean fewer securities firms and big bank domination of municipal bond underwriting. To quote an October 19, 1979 SEC report:

"While it cannot be predicted how many, if any, firms would not remain in the securities industry due to expanded bank MRB [municipal revenue bond] underwriting, the potential exit of securities firms could lessen any competitive gains from bank entry. Moreover, because of the importance of the smaller firms in underwriting smaller issues the loss of these firms could have an impact on the ability of small municipalities to meet their financing needs. Finally, any adverse impact on smaller, regional broker-dealers may have serious implications for the corporate business formation process, particularly for small businesses." (Bank Participation in Municipal Revenue Bond Underwriting: Impact on Securities Industry Revenues)

The Bank's Proposal is A One-Way Street

Mr. Chairman, we know you well recognize the unique power of the commercial banks. The banks' proposal as incorporated into H.R. 2828, H.R. 3000, H.R. 4040 and S. 1424, as well as Title III of your bill S.1720, constitutes a one-way invasion of our industry by the banks without their surrendering any of their special bank advantages. These unique advantages have been pointed out time and time again, but the banks have chosen not to change their proposed legislation in any way to respond to these concerns. They must, we assume, wish to keep the benefits of these advantages as they move beyond the field of commercial banking. And they do not want any of those special advantages to be conferred upon the securities industry.

In your May hearings you asked Mr. Gunderson, the president of the ABA, if securities firms should have the right to take deposits. He did not agree. At that time you stated your interest in solving the question of equity so that perhaps one

day banks and securities firms might compete with each other for deposits and, as you so well put it, "Whoever wins is fine." We, too, are interested in equity and free competition and what is best for the municipalities, consumers and businesses of this country.

Such a one-way invasion of our industry as urged by the banks can only result in serious harm to the capital markets and the entire economy. We believe the fundamental principle of Glass-Steagall, the separation of commercial and investment banking activities, has served the nation well and remains as vital to a flourishing, diverse capital formation system as it did when that historic legislation was enacted.

Secretary Regan's Separate Subsidiary Proposal Recognizes Existing Inequities

The Secretary of the Treasury in his testimony on Monday proposed that a bank holding company be allowed to underwrite all municipal bonds, including revenue bonds, and to operate mutual funds through a separate "public securities" subsidiary divorced from the rest of the bank holding company complex. We are gratified that the Secretary has recognized by his proposal that the special advantages of a commercial bank - which they presently have - can be destructive of competition outside the field of banking. Many of the SIA's concerns were communicated to the Secretary in a letter dated October 16, 1981, a copy of which is Appendix D to this statement. We appreciate the seriousness of his attempt to maximize fair and efficient

competition in the public securities marketplace for all participants and, to the extent possible, to avoid the serious problems of conflicts of interest and other abuses which we know from past history can occur when commercial and investment banking activities are pursued within the same organization.

The Secretary in his proposal addresses a number of the serious problems of competitive advantages and conflicts of interest which we have discussed in this statement, but by no means all. We are not sure that the changes he suggests can or will result in a better or more competitive financial marketplace, but we agree that the Secretary's proposal should be thoroughly explored and developed. Our first review of the Secretary's testimony leads to some initial questions. We are sure that many more will arise as the details and implications of his proposal emerge.

How separate from the members of the bank holding company complex can the securities subsidiary be? For example, can a structure be developed, and to what extent should it be, to prohibit interaction of capital, mutual customers, flow of information and joint activity, such as the packaging of credit and underwriting services? Should directors and other personnel in common between the securities affiliate and members of the bank holding company complex be forbidden? How can the subsidiary be prevented from trading on the name identification of members of the bank holding company? Should it not have a completely different name and be forbidden from identifying itself as a member of the bank holding company complex?

Excepting perhaps initial capital, should not the subsidiary be barred from obtaining any loans or equity from members of the bank holding company complex? How would reciprocal dealing between the affiliate of one bank holding company complex with the members of another bank holding company complex in return for similar dealings be prevented? Can the subsidiary be so isolated as to avoid the benefit of the preferential tax advantages currently enjoyed by commercial banks and the benefits of federally-insured deposits? Should separate business locations for the securities subsidiary, apart from any business location of a member of a bank holding company be required? Should the regulatory supervision of the subsidiary be identical to that for a similarly situated securities firm?

Why should not the present inequities favoring commercial banks over securities firms, as recognized by Secretary Regan, be eliminated, regardless of the question of revenue bond underwriting? Can an effective "Chinese wall" be erected?

How would the captive market problem be eliminated? To what extent and will the securities subsidiary be prohibited from dealings with the portfolios, and trust and pension accounts of members of the bank holding company complex and with those banks of having correspondent relationships with members of the complex? Should the securities subsidiary be barred from dealing with major customers of the banks in the same complex to avoid, for example, shifting risks from the banks to the securities subsidiary and vice versa? Can the risk activity of the securities affiliate be effectively isolated from federally

insured deposits?

As a practical matter, can the problems of conflicts, of tie-in's and those arising from multiple relationships be eliminated? What disclosure mechanisms should there be to monitor such protective measures?

Is the Administration's approach the right one? We do not know yet, but it may well be. It certainly represents a fresh and challenging initiative which deserves the most careful consideration. We applaud Secretary Regan for advancing the proposal and pledge ourselves to work with him and this Committee, Mr. Chairman, to search for a fair solution in the public interest.

But the primary questions remain:

Will a better financial marketplace result?

Will state and local governments be better off?

Will small, independent commercial banks benefit?

What will be the impact on smaller and regional securities firms?

Will small businesses, venture capital opportunities and technological companies in need of capital have more or fewer places to go?

Will the regulatory environment be simpler or more complex?

Will the changes be worth it?

There exists no emergency threatening the commercial banking system. The dozen or so principal beneficiaries of this proposed change are quite healthy, even more so with the bonanza bestowed upon them by the recent All-Savers legislation. There is time for careful consideration of this matter separate from the

timetable which may be required to resolve problems confronting the thrift institutions.

You have our pledge to maintain the vigorous competition that characterizes our industry today and to support any initiatives that will enhance fair and efficient competition across the entire spectrum of the financial services marketplace. If Congress examines this intricate and complex situation with care and considers thoughtfully the policy questions involved and the interests of state and local governments and the citizens and businesses of America as well as the legitimate interests of the commercial banks and the securities industry, we are sure that it will reach a solution which is in the public interest. The obvious context for this work is your comprehensive review of Glass-Steagall early next year and we commit ourselves to working with you and the Administration in an expeditious manner to develop a sound and fair setting for commercial bank and investment banker competition.

FOOTNOTES

¹ This quotation appears in an opinion dated November 6, 1911 that Solicitor General Frederick W. Lehmann submitted to Attorney General Wickersham. It was quoted at Hearings before the Senate Committee on Banking and Currency pursuant to S. Res. 84, 72d Cong., 1st and 2d Sess., p. 2029. These Hearings will be cited hereafter as 72d Cong. Hearings.

² *Id.*, at p. 2030. Oddly enough, no action was ever taken, although Attorney General Wickersham apparently concurred in this opinion. *Id.*, at p. 2043.

³ Hearings before Senate Committee on Banking and Currency pursuant to S. Res. 56 and 97, 73d Cong., 1st and 2d Sess., p. 3978 (hereinafter cited 73d Cong. Hearings), where the Honorable Winthrop W. Aldrich stated: "The thought, however, that the overlapping of interest as between commercial banking and investment banking might be subject to grave danger was not in any sense a new one. The hearings and the report of the Pujo Committee dated February 28, 1913, had pointed out the desirability for such changes." For the Pujo Committee Hearings and Report, see Hearings before a Subcommittee of the House Committee on Banking and Currency pursuant to H. Res. 429 and 504, 62d Cong., 2d Sess., part 28 of which contains the Committee report.

⁴ Quoted at Hearings before a Subcommittee of the Senate Committee on Banking and Currency pursuant to S. Res. 71, 71st Cong., 3d Sess., p. 1067. These Hearings will be cited hereafter as 71st Cong. Hearings.

⁵ See statement of Charles E. Mitchell, *id.*, at p. 318; also 73d Cong. Hearings, *supra* note 3, p. 4388, where Robert O. Lord, in his testimony regarding the Guardian Detroit Group, stated that one reason for the acquisition of Keane, Higbie & Co. was that "contacts with some of their customers helped in securing business for the banks and trust companies;" and *id.*, at p. 4789, where Frank W. Blair, formerly president of the Union Trust Co. of Detroit and chairman of the board of the Guardian Detroit Union Group, Inc., stated in a letter that Mr. Higbie had urged the acquisition of Keane, Higbie & Co., as one "which would be able to contribute trusteeships from the companies they financed, bank accounts from industries with which they were in close relationship, and lastly as one which would contribute very substantial earning power under conditions as they then prevailed."

⁶ 72d Cong. Hearings, supra note 1, pp. 2013-15, 2019, 2021.

⁷ Id., at pp. 2019-20. Customers of the National Bank of Commerce, Detroit, for example, "complained that they made the loan in order to buy certain securities recommended by an officer of the bank or securities in which this bank or some affiliated institution was directly or indirectly interested." See 73d Cong. Hearings, supra note 3, p. 4495.

⁸ See 72d Cong. Hearings, supra note 1, pp. 1872-77, for details of an employees' stock purchase plan under which employees of the National City Bank were persuaded to subscribe to the purchase of 20,000 shares of bank stock at from \$200 to \$220 per share after the crash in October and November 1929. The employees were held strictly to their subscription contracts despite a decline that brought the price on such stock to \$40 by 1933. See also 73d Cong. Hearings, supra note 3, p. 7987, for a discussion of the sale by Guardian Securities Company of Cleveland of about 2,000 shares of a 15,000 share issue of Inland Investors, Inc., stock to employees of its affiliate, the Guardian Trust Co., on the partial payment plan at \$52.50 per share. The market price subsequently declined, reaching about \$9 per share at the time of the investigation.

⁹ 71st Cong. Hearings, supra note 4, p. 502.

¹⁰ 72nd Cong. Hearings, supra note 1, p. 2221.

¹¹ 73d Cong. Hearings, supra note 3, p. 953.

¹² 71st Cong. Hearings, supra note 4, p. 299.

¹³ 73d Cong. Hearings, supra note 3, pp. 7996-97, 8132, 8140, 8256-57.

¹⁴ At one point, Ferdinand Pecora, counsel to the subcommittee, quoted a memorandum to the effect that a "First Detroit Co., which is one of the investment or security affiliates or units of the Detroit Bankers Co., acquired certain of these Watson Realty Co. mortgage bonds at 93 1/2, transferred them to the Detroit Trust Company the same day at 95.759 and that the Detroit Trust Co. sold those mortgage bonds, some of them at par and some at 97, to various trusts committed to its care." Mr. William J. Thomas, Treasurer of the Detroit Trust Co., testified: "I know that many sales were made of that nature." 73d Cong. Hearings, supra note 3, pp. 5295-96. See also, id., at p. 5300-5301. On one occasion, although some of the underlying mortgages were already in default, this trust company sold mortgage participations to trust accounts managed by it. See also p. 5353.

"The Guardian Trust Co. in its capacity as trustee, has violated its fiduciary relationship in more than one instance by

burdening trust estates over which it had discretionary investment powers, with securities in which the bank realized a profit by the expedient of passing securities through its bond department, and subsequently to its estates." *Id.*, at p. 7986. See *id.*, pp. 8063-8068, for other instances where there were violations of a fiduciary relationship by a bank whose trust department bought bonds from its bond department.

¹⁵ For example, in the failure of the Guardian Detroit Union Group with a deficit of nearly \$15,000,000, nearly \$6,500,000 was attributable to securities losses in their two largest affiliates. *Id.*, at pp. 4701-02, 4981-83. In October 1933, the Union Cleveland Corporation, a securities affiliate of the parent Union Trust Company (Cleveland), had a deficit of nearly \$2 million, completely wiping out its surplus and almost all of the stockholders' equity; the depositors of the parent Trust Company received only 40 cents on the dollar when it closed. *Id.*, at pp. 8132, 8140, and 8256-57. The Guardian Trust Company (Cleveland) had losses of nearly \$30 million, partly occasioned by its "engagement in practically every type of business along with the banking business", which brought about a potential deficit of about \$12 1/2 million; in February 1932, a year before its closing, the bank was hopelessly insolvent. *Id.*, at pp. 7982-83.

The whole era is best summed up in the colloquy between Albert H. Wiggin, former president of the Chase National Bank, Ferdinand Pecora, counsel to the Senate Committee, and Senator Couzens of Michigan, just after Mr. Wiggin's testimony revealed that Chase Securities Corporation had suffered realized and unrealized losses of over \$120,000,000--nearly six times the dividends paid out during its entire existence since 1917: Senator Couzens--"Would you consider that a very good record?" Mr. Wiggin--"Oh I think that is a very unfortunate record, but this is world trouble and we are probably better than the average. There are some security companies that were wiped out, many of them." Mr. Pecora--"Do you think this record vindicated the judgment of the authorities of the bank when through the securities affiliate they engaged in issuing securities and underwriting them, trading in them?" Mr. Wiggin--"The figures do not verify that; no, sir." *Id.*, at pp. 2406-07.

¹⁶ *Id.*, at p. 4027.

¹⁷ 72d Cong. Hearings, supra note 1, pp. 3977-3981.

APPENDIX I

October 22, 1981

IMPACT OF COMMERCIAL BANK
UNDERWRITING OF MUNICIPAL
REVENUE BONDS ON INTEREST COSTS

George G. Kaufman

Professor of Economics and Finance
and Director of the Center for
Financial and Policy Studies,
Loyola University of Chicago

It has been alleged that if commercial banks were permitted to underwrite all municipal revenue bonds, they would be able to reduce interest costs of borrowing to state and local governments. A careful review of this argument, however, indicates that both the underlying economic theory and the supporting empirical evidence are seriously flawed. In fact, there is neither any theory nor any evidence whatsoever that suggests that making commercial banks eligible to underwrite all municipal revenue bonds would do any more than reshuffle the market shares of individual underwriting firms and replace some investment banks by commercial banks.

In 1978, I and some of my colleagues were asked by the Securities Industry Association to examine independently a study by Professor Phillip Cagan undertaken for the Dealer Bank Association that reported evidence of astonishing cost savings amounting to more than \$400 million in present value in 1977 alone if commercial banks were permitted to underwrite all revenue bonds. This is equivalent to about \$25 per \$1,000 bank ineligible bonds issued in that year. Moreover, almost

all the total savings comes from higher prices paid (lower interest rates received) by investors. Only a small fraction -- \$7 million of the more than \$400 million -- comes from lower spread or profits by the underwriters. We subjected the Cagan study, as well as all other studies in this area, to the most careful scrutiny possible. We found three major flaws in the Cagan study that greatly affected his conclusions:

1. there were serious errors in the classification of bank eligible bonds so that about 25 percent of the bonds in his sample were incorrectly classified,
2. he used an incompletely specified economic model that statistically confused bank eligibility with other characteristics of the bonds that were not specified in the model, and
3. he assumed, contrary to the evidence, that bank eligibility would cause state and local governments to sell more of their bonds by competitive bid than by negotiation.

We corrected each of these errors. The commercial bank eligibility status of each bond in Cagan's sample was determined by the respected independent municipal bond counsel firm of Wood and Dawson. Cagan's basic econometric model was extended to control for all possible characteristics of municipal revenue bonds. Most importantly, we included the purpose for which the bonds were issued, e.g., housing, hospital, parking facilities, etc., a characteristic the market uses to determine credit quality in addition to the letter credit ratings provided by the major rating agencies. When these corrections are made,

Cagan's own sample of municipal revenue bonds issued between 1973 and 1976 shows no statistically significant interest cost differences between bank eligible and bank ineligible bonds sold either by negotiation or by competitive bid.¹ These results are summarized in Table 1. (The "basic model" is equivalent to Cagan's model.)

Moreover, these findings are even more conclusive when the analysis is updated to include revenue bonds sold in 1979. As may be seen from the second set of columns in Table 1, when the 1979 data are applied to Cagan's original nonexpanded model, which was used to obtain his earlier results, bank eligibility actually increases the interest cost of the bonds by reducing the number of bids.² This is highly implausible and serves to support our skepticism of the abbreviated model. However, when the expanded model is used, these effects disappear and the impact of bank eligibility on interest cost is again statistically insignificant in either direction. Indeed, the results for 1979 are statistically indistinguishable from those obtained for the entire 1973-76 period. Our model and data have been made freely available to everyone, including government agencies, and copies

¹G. O. Bierwag, Michael Hopewell, and George G. Kaufman, Bank Eligibility To Underwrite Municipal Revenue Issues and the Cost of Borrowing. (New York: Securities Industry Association, August 1979).

²G.O. Bierwag, Michael H. Hopewell, George G. Kaufman, and Paul A. Leonard, Commercial Bank Eligibility To Underwrite Municipal Revenue Issues and the Cost of Borrowing: Additional Evidence for 1979. (Eugene, Oregon; Center for Capital Market Research, University of Oregon, September 1980).

are submitted for your records. To the best of my knowledge, no one has found any errors either in our statistical analysis or in our conclusions.

What economic theory may be used to support an argument that permitting commercial banks to underwrite additional municipal securities would reduce their interest rates? The most obvious theory focuses on insufficient competition. But there are some 900 nonbank municipal bond dealers, and even Cagan does not claim insufficient competition. Only 2 percent of his potential cost savings are attributed to reduced spreads. If there were insufficient competition, it would be unlikely that a giant investment banking firm such as Morgan Stanley, which does not underwrite municipal revenue bonds except industrial revenue bonds as a service to their corporate clients, would choose to stay out of the action. Instead, the argument is based on the hypothesis that the larger the number of potential underwriters, the more intense will be the search for investors who would buy the securities at higher prices (lower interest rates). But this is a strange hypothesis that does not stand up well to close scrutiny. Increased competition in the sale of securities to the same investors should result in lower prices (higher interest rates), not in higher prices. Thus, the hypothesis relies on increased competition stimulating a search for new investors. But it appears highly unlikely that sufficient new investors could be found to offset the "pure competition" effect. After all, how many potential investors

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in municipal securities, large or small, have not heard the thundering hoofbeats of Merrill Lynch, listened silently to E. F. Hutton's recommendations, thanked Paine Webber, or sympathized with Bache's early morning risers? If they buy equities, they both know security dealers and are known by security dealers. Are Morgan Stanley, Salomon Brothers, Goldman Sachs, or the above firms any less aggressive than commercial banks? Unlikely, in light of their rising share of both the general obligation bond underwriting market, in which commercial banks may participate freely, and the revenue bond underwriting market, even after the large increase in bank eligible housing bonds in recent years. Thus, if commercial banks are to be legally permitted to underwrite all municipal revenue bonds, it needs to be justified for reasons other than that it would reduce interest costs to state and local governments.

TABLE 2
SPECIFICATION OF REGRESSION MODELS

Dependent Variable: NIC	
Competitive Model	Negotiated Model
Basic Set	Basic Set
Issue Size	Issue Size
Market Index	Market Index
Yield Curve	Yield Curve
Effect	Effect
Moody's Rating	Moody's Rating
Years to First	Years to First
Call	Call
Number of Bids	
Additional Set	Additional Set
Standard and	Standard and
Poor's Rating	Poor's Rating
Issue Purpose	Issue Purpose
Dependent Variable: Number of Bids	
Competitive Model	
Basic Set	
Issue Size	
Market Index	
Yield Curve	
Effect	
Moody's Rating	
Years to First	
Call	
Additional Set	
Standard and	
Poor's Rating	
Issue Purpose	
Issue Purpose	
Housing	
Hospital	
Water/Sewer	
Electric/Gas	
University	
Ports/Airports	
Schools	
Roads	
Other	

BANK ELIGIBILITY EFFECT ON INTEREST
COSTS ON MUNICIPAL REVENUE BONDS

REGRESSION RESULTS

		BANK ELIGIBILITY			
		1973-76		1979	
		Regression Coefficient	Statistical Significance (t number)	Regression Coefficient	Statistical Significance (t number)
		(163 issues)		(197 issues)	
<u>Negotiated Sample</u>					
<u>Net Interest Cost (Basis Points)</u>					
Basic (Cagan) Model					
Basic & Bank Eligibility		-0.235	-2.01	0.103	1.33
Basic & Purpose					
Complete Model		0.051	0.26	0.029	0.22
<u>Competitive Sample</u>		(652 issues)		(199 issues)	
<u>Net Interest Cost (Basis Points)</u>					
Basic (Cagan) Model					
Basic & Bank Eligibility		0.087	2.61	0.199	3.67
Basic & Purpose					
Complete Model		0.067	1.50	0.042	0.55
<u>Number of Bids</u>					
Basic (Cagan Model)					
Basic & Bank Eligibility		0.301	1.34	-0.720	-2.57
Basic & Purpose					
Complete Model		0.327	1.66	-0.250	-0.62

APPENDIX II

STATEMENT OF PROFESSOR MICHAEL MUSSA

Concerning the Effects of an Expansion
of Commercial Bank Authority
to Underwrite Municipal Revenue Bonds

Mr. Chairman, my name is Michael Mussa. I am the William H. Abbott Professor of International Business at the University of Chicago. For the past three years, I have served as a consultant to the Securities Industry Association on the subject of expanded commercial bank underwriting of municipal revenue bonds, and I have prepared a number of studies on this subject which I shall be happy to make available to the Committee.^{1/} I appear today, at the request of the Securities Industry Association, to testify against the provisions of S.1720 that would allow commercial banks to expand their activities in underwriting and dealing in municipal revenue bonds.

The case for an expansion of commercial bank authority to underwrite municipal revenue bonds is based largely on two misleading and fallacious arguments: that present restrictions on commercial

^{1/} These studies include "Competition and Borrowing Cost in the Municipal Revenue Bond Market: An Appraisal of the Evidence," Securities Industry Association, January, 1979; "Response to the Dealer Bank Association's Claims Concerning Interest Savings from Bank Underwriting of Municipal Revenue Bonds," Graduate School of Business, University of Chicago, May 14, 1979; "Competition, Combination and Commercial Bank Involvement in the Municipal Revenue Bond Market," Graduate School of Business, University of Chicago, June 27, 1979 (presented at hearings before the Securities and Exchange Commission and the House Subcommittee on Financial Institutions); and "Interest Savings from Bank Underwriting of Municipal Revenue Bonds: What Have We Learned from the Recent Debate," Graduate School of Business, University of Chicago, January 1980.

bank activities in this field represent a serious barrier to adequate competition in the underwriting of municipal revenue bonds; and that removal of these restrictions would generate substantial interest savings for issuers of revenue bonds that are not presently eligible to be underwritten by commercial banks. Purported support for these arguments has been provided by a statistical study conducted by Prof. Phillip Cagan (and sponsored by the Dealer Bank Association), which estimated that the present value of interest savings for ineligible revenue bonds issued in 1977 would have been \$412 million, and by a survey of previous statistical studies conducted by Prof. William Silber (and sponsored by the American Bankers Association and the Dealer Bank Association) which concluded that present value of interest savings for ineligible revenue bonds issued in 1977 would have been between \$80 million and \$369 million.^{2/}

The fallacy in the argument of inadequate competition is revealed by consideration of the following facts. First, as a logical matter, existing restrictions on the underwriting activities of commercial banks limit only the combination of certain underwriting

2/ Prof. Cagan's estimate is presented in, "Interest Savings to States and Municipalities from Bank Eligibility to Underwrite All Nonindustrial Municipal Bonds," Government Finance, May 1978. Prof. Silber's estimates of interest savings are presented in, "Municipal Revenue Bond Costs and Bank Underwriting: A Survey of the Evidence," Monograph Series in Finance and Economics, 1979-3, New York University, Graduate School of Business Administration, Salomon Brothers Center for the Study of Financial Institutions.

activities with commercial banking; they do not directly restrict the extent of competition in the activity of revenue bond underwriting. Any nonbank firm (that meets certain minimum requirements) can underwrite municipal revenue bonds. Moreover, there is no legal restriction on the means and extent of competition either for existing underwriters or for potential entrants to the field. Second, as a matter of fact, there are a large number of securities firms (over 900) that vigorously compete in the underwriting of municipal revenue bonds. The concentration of this activity (as measured by the share of the four leading managers of revenue bond underwriting syndicates) is lower than in 90 percent of U.S. manufacturing industries. Third, there is persuasive evidence of the absence of any effective barrier to entry of new securities firms into the activity of revenue bond underwriting. This is testified to by the high turnover rate among leading underwriters of municipal revenue bonds; during the past 15 years, more than 20 different securities firms have been among the annual top ten underwriters. Indeed, the leading underwriter during the past five years, Goldman Sachs, was not among the top ten a decade ago, when it jumped in at the number two position. There remain more than 2,000 securities firms that are not now active in revenue bond underwriting. Many of these firms (as well as entirely new securities firms) could easily enter this activity and would probably do so if the prospective profits exceeded competitive levels. These potential entrants include the large investment banking firm of Morgan Stanley that presently

underwrites only pollution control bonds as a service to its corporate clients, but could easily become a leading underwriter of all other types of tax-exempt securities. In sum, there is no legal or effective barrier to competition in the activity of underwriting municipal revenue bonds.

The fallacy in the argument that an expansion of bank underwriting authority would generate large interest savings for bond issuers was convincingly demonstrated in the debate among the academic experts that culminated in the Hearings before the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance.^{3/} Even some of the supporters of bank underwriting who continued to believe that it would generate some interest savings were compelled by the weight of argument and evidence to conclude that Prof. Cagan's estimate of over \$400 million of savings for bonds issued in 1977 was greatly exaggerated. In particular, in his statement to the House Subcommittee, Deputy Secretary of the Treasury Robert Carswell states:^{4/}

"We have reviewed these studies [of savings to bond issuers from an expansion of bank underwriting authority] and have concluded that they do not provide sufficient basis for assuming that issuer savings will be on the order of \$400 million. Our general conclusion is that savings will be of a considerably more modest order of magnitude."

^{3/} See "Bank Holding Company Legislation and Related Issues," Hearings before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 96th Cong., 1st Sess., Parts 1 and 2, U.S. Government Printing Office, 1980.

^{4/} See "Hearings," op. cit., p. 1360.

Since the conclusion of the hearings before the House Subcommittee, a new statistical study has been conducted (under the sponsorship of the Securities Industry Association) by Prof. George Kaufman and his collaborators at the University of Oregon.^{5/} This new study is based on a random sample of revenue bonds issued in 1979, some eligible for underwriting by banks, and some ineligible. Like the earlier Kaufman study, this new study shows that when account is taken of all measurable factors affecting interest costs for bond issuers, bank eligibility has no statistically significant effect on interest cost. In fact, in this new study, the measured (but not statistically significant) effect of bank eligibility is actually to increase interest costs.

Since the conclusion of the hearings before the House Subcommittee, the advocates of expanded bank underwriting authority have shifted away from the discredited Cagan study and have relied on a new study of interest savings to bond issuers written by Prof. William Silber. The Silber study does not present any new factual evidence of statistical results; it simply reviews the results of other studies written prior to October 1979. Based on these other studies, Prof. Silber constructs 16 possible estimates of the present value of interest savings for ineligible revenue bonds issued in 1977, ranging from a low of \$80.2 million to a high of \$369.2 million.^{6/}

^{5/} See G. O. Bierwag, Michael H. Hopewell, George G. Kaufman and Paul A. Leonard, "Commercial Bank Eligibility to Underwrite Municipal Revenue Issues and the Cost of Borrowing: Additional Evidence for 1979," Center for Capital Market Research, University of Oregon, September 1980.

^{6/} See Silber, op. cit., pp. 40-42 and p. 58.

At the request of the Securities Industry Association, I prepared a review of the Silber study and of other studies of interest in January 1980.^{7/} In that review, I note the following defects in Prof. Silber's range of estimates. First, 8 out of the 16 estimates assume that there would be a savings of \$57.6 million due to a shift of underwriting technique from negotiated sale to sale through advertised bidding. There is no credible evidence, however, that eligibility for a bond issue to be underwritten by commercial banks has any effect on the choice of underwriting technique. Indeed, a study by Ronald W. Forbes and John E. Peterson has shown that when local issuers of general obligation bonds in the State of Pennsylvania were allowed the option of negotiated sale (rather than being compelled to sell their bonds through advertised bidding), 95 percent of these issuers voluntarily chose negotiated sale.^{8/} Since these general obligation bonds are eligible to be underwritten by commercial banks, this study clearly indicates that eligibility for bank underwriting

7/ See Michael Mussa, "Interest Savings from Bank Underwriting of Municipal Revenue Bonds: What Have We Learned from the Recent Debate," Graduate School of Business, University of Chicago, January 1980.

8/ See Ronald W. Forbes and John E. Peterson, "Local Government General Obligation Bond Sales in Pennsylvania: The Cost Implications of Negotiation vs. Competitive Bidding," in "Hearings," op. cit., pp. 493-546. Forbes and Peterson argue in this study that competitive bidding results in lower interest costs than negotiated underwriting. I do not believe, however, that the evidence they present justifies this conclusion. Their study does justify the conclusion that eligibility for underwriting of bonds by commercial banks does not induce bond issuers to choose competitive bidding.

does not induce a shift of underwriting technique away from negotiated sale. Second, of the eight remaining estimates in Silber's range of estimates, three are based on comparisons of interest costs and bidding activity between revenue bonds and general obligation bonds. It is widely recognized, even by some of the academic experts previously employed by the banks, that such comparisons do not yield valid estimates of the interest savings likely to result from an expansion of bank underwriting authority. On average, general obligations involve lower yields than revenue bonds (within the same rating class) because they are regarded by investors as providing better security for the payment of interest and the repayment of principal. The easier marketability of general obligation bonds to investors stimulates greater bidding activity by underwriters when such bonds are sold through advertised bidding. Third, of the remaining five estimates in Silber's study, two include an estimate of \$4.00 per thousand dollar bond from reduced underwriting spread. This figure is equal approximately to the average profit that underwriters earn on each bond (taking account of all expenses including salesmen's commissions). Since there is no evidence from underwriting activities for presently eligible revenue bonds that banks have significantly lower underwriting costs than securities dealers, and since banks are presumably not in the underwriting business to take a loss, these two estimates must be rejected on the grounds of implausibility.^{2/}

^{2/} Banks do have some artificial advantages relative to securities dealers in underwriting and dealing in municipal bonds.

[Footnote continued]

The three remaining estimates in Silber's study range from a low of \$80.2 million to a high of \$126.9 million. In my review of Silber's study, I detail the evidence indicating that these estimates possess a serious upward bias, and I show that the best available evidence suggests interest costs savings of only about one dollar per thousand dollar bond, or about \$20 million for the ineligible revenue bonds issued in 1977. My confidence that this is an upper bound figure for the magnitude of probable savings is strengthened by the results of the new study by Prof. Kaufman and his collaborators which indicates that there may be no savings from an expansion of bank underwriting authority. Moreover, my conclusion of savings of about one dollar per thousand dollar bond applies only in the short run for which it may be assumed that dealer banks would add to the total number of underwriters. In the longer run, if dealer banks merely displaced securities dealers as municipal bond underwriters, the interest savings to bond issuers would be negligible.

Further, on the subject of interest cost savings, it should be emphasized that all estimates of large savings (above three or four dollars per thousand dollar bond) rely on the unsupported assertion that making bonds eligible for underwriting by commercial

[Footnote 9 continued]

In particular, there is the tax advantage (principally relevant for dealing in the secondary market) that banks can deduct the interest expense of their inventory of tax-exempt bonds. The evidence that banks do not dominate the general obligation market or the eligible revenue bond market, however, suggests that these advantages do not reduce underwriting costs for banks by as much as \$4.00 per thousand dollar bond.

banks enable these bonds to be sold to investors at significantly lower yields. In particular, out of Prof. Cagan's now discredited estimate of \$412 million of savings for bonds issued in 1977, only \$7 million was attributed to reduced spreads earned by underwriters. The other \$405 million was supposed to result from selling these bonds to investors at significantly lower yields (about 20 basis points) than the yields at which they were actually purchased. Who are these investors who are willing to accept lower yields than are presently obtainable on municipal revenue bonds? Why cannot these investors be found by securities dealers who have a strong profit incentive to sell the bonds they underwrite at the lowest possible yield (the highest possible price)? How can dealer banks, who, by their own admission, rely on securities dealers for retail distribution to individual investors, expect to expand this sector of the municipal bond market, when securities dealers purportedly cannot do so?^{10/} How can dealer banks expand the demand for municipal bonds (at lower yields) by financial institutions that are a known clientele whose demand for tax-exempt bonds is determined primarily by their

^{10/} In his testimony at the "Hearings" (op. cit., p. 480), Mr. E.B. Robinson President of the Dealer Bank Association states, "A traditional strong role of the small dealer in underwriting syndicates is to provide a means of distributing the bonds to individual investors. In today's general obligation market, the major bank underwriters unlike the large investment banking firms, do not have the benefit of nationwide branch offices. Therefore, it is these banks that must rely most heavily on the small dealer firms around the country for their distribution capabilities. The banks would continue to need to rely on such small regional firms for the distribution of revenue bonds underwritten by syndicates they manage, as they now do in the GO market."

potential tax liability and by the availability and attractiveness of alternative tax shelters? Would not any increase in demand for presently ineligible revenue bonds by dealer banks and by their current customers come largely at the expense of purchases of general obligations and presently eligible revenue bonds, with the interest savings to issuers of presently ineligible revenue bonds offset by higher interest costs for issuers of general obligation and presently eligible revenue bonds? Would dealer banks have pressed so hard and so long for an expansion of their underwriting authority if they really believed that its principal consequence would be a reduction in the yields they would earn on their own future investments in municipal revenue bonds by considerably more than they could expect to earn from increased underwriting profits?

All of these questions were posed, in one form or another, in my initial criticism of Prof. Cagan's estimate of interest savings, and they are equally relevant to most of Prof. Silber's estimates. Most of these questions were asked, repeatedly, during the recent hearings before the House Subcommittee on Financial Institutions. No effective and convincing answer has ever been given. Until such answers are forthcoming, no one should accept the assertion that an expansion of bank underwriting authority would generate substantial interest cost savings for municipal bond issuers.

Even if interest savings are small, doubtful and transient, municipal bond issuers are understandably anxious to get whatever help they can. From the broader social perspective, however, the possibility of small interest savings must be weighed against three

important disadvantages of any expansion of commercial in investment banking in general and in municipal bond underwriting in particular. First, there is the problem of conflicts of interest between the role of banks as underwriters and dealers in municipal bonds and their primary banking responsibilities. One dimension of this problem arises from the interaction between bank underwriting and bank investment in municipal bonds. Evidence gathered by the Senate Antitrust and Monopoly Subcommittee indicated that more than 80 percent of new investments in general obligation bonds for five of the ten leading dealer banks were from syndicates in which these banks participated as underwriters.^{11/} This suggests the possibility that these banks were failing to fulfill their banking responsibility to act as an impartial source of credit and their responsibility as underwriters to serve equally the demands of all potential investors. The proposed legislation in S.1720 does not provide an adequate remedy for this problem since it limits only bank purchases from their own underwriting account and specifically exempts bank purchases from the general syndicate account. A minimum safeguard would be to require commercial banks to publicly report the purchases and sales of their investments in municipal bonds (both revenue bonds and general obligations) and to indicate the prices at which these

^{11/} This evidence is summarized in the statement of Prof. Simon Whitney in "Trading in Municipal Securities," Hearings before the Subcommittee on Securities of the Committee on Banking, Housing and Urban Affairs, U.S. Senate, 93rd Cong., 2nd Sess., U.S. Government Printing Office, 1974, pp. 350-402.

transactions were carried out. A more adequate safeguard would be to prohibit all bank purchases of municipal bonds from issues in which the bank participates as an underwriter for at least thirty days after the closing of the underwriting syndicate.

Second, there is the problem that expanded bank participation in municipal bond underwriting may be based on artificial advantages which allow banks to compete on an unfair and uneconomic basis. One such advantage (principally relevant for dealing in the secondary market) is the ability of banks to deduct the interest cost of carrying their inventory of tax-exempt bonds. Another advantage arises from the ability of banks to exploit their dual role as underwriters and investors in municipal bonds, to the detriment of both other underwriters and other investors. A third advantage is the lower cost of funds enjoyed by banks as a consequence of the explicit and implicit insurance of their deposit liabilities by the federal government. In addition, banks have access to finance through the federal funds market and the Federal Reserve discount window that is not available to securities dealers. The exploitation of these advantages implies that banks may not only be able to compete on an unfair basis with securities dealers, to the detriment of those dealers, but also that their participation in municipal bond underwriting might be uneconomic and inefficient from a social perspective. The importance of this point is indicated by the estimate of Deputy Secretary of the Treasury Robert Carswell that the cost to the Treasury of the special

tax advantage enjoyed by banks is on the order of \$25 million.^{12/} This is about the same order of magnitude as the possible interest savings to bond issuers from an expansion of bank underwriting authority.

Third, there is the problem of increased concentration of financial power that arises from any expansion of the financial dominance of the nation's largest banks. This is not so much an economic problem as it is a political concern, especially in a country that has traditionally been suspicious of any large concentration of financial power. An increase in bank authority to underwrite and deal in municipal revenue bonds would clearly result in some increase in the financial power of large banks. The cumulative consequence of a number of such increases resulting from further encroachments of commercial banks into investment banking might well be a substantial increase in the financial power of large banks that runs counter to the traditional American opposition to such concentration of power. Moreover, the damage to regional securities dealers from only the expansion of bank activities in the revenue bond market might significantly impair the

^{12/} See "Hearings," op. cit., p. 1378. It should be noted that Secretary Carswell's estimate of the benefit of the tax advantage to commercial banks is little more than an informed guess. It might be that more refined analysis would reveal that the magnitude of this benefit is either significantly greater or significantly less than \$25 million.

capacity of these firms to assist smaller American business in acquiring the equity capital they require to sustain the growth process.^{13/}

^{13/} The SEC Report, "Bank Participation in Municipal Revenue Bond Underwriting: Impact on Securities Industry Revenues," October 1979, documents the importance of underwriting as a source of income to smaller regional securities firms. The reports, "Initial Public Offerings of Common Stock: The Role of Regional Broker-Dealers in the Capital Formation Process" and "The Role of Regional Broker-Dealers in the Capital Formation Process: Underwriting, Market-Making and Securities Research Activities," published jointly by the SEC and the Small Business Administration (in March 1980 and August 1981, respectively), document the importance of smaller regional securities firms in generating equity capital for smaller businesses.

Appendix A

Analysis of "Safeguards" In S.1720 (Title III)

The proponents of bank underwriting of municipal revenue bonds make much of the supposed restrictions contained in S.1720. These restrictions are claimed to be the panacea which somehow resolves the basic conflicts of interest arising between a bank's underwriting position and the interests of its depositors, trust accounts, customers and stockholders. The so-called protections of S.1720, however, are illusory at best.

For example, Clause (1) provides that a bank may not invest in revenue bonds and other non-general obligations of any one issuer in excess of 10% of the bank's capital and surplus. But this provision offers no greater limitation on the concentration of bank investment in particular revenue bond issues than that which would in any event be afforded under existing law. Since 1933, the federal banking laws have forbidden banks from holding more than 10% of bank capital and surplus in the securities other than general obligations -- of any one issuer. Paragraph Seventh, 12 U.S.C. §24; 12 U.S.C. §335. This same 10% restriction, which applies both to national banks and to member state banks of the Federal Reserve System, is incorporated as well in regulations promulgated by the Comptroller of the Currency and the Board of Governors of the Federal Reserve System. See 12 C.F.R. §§1.7(a) and 250.121 (1978).

Clause (2) prohibits the purchase by a bank as fiduciary from the same bank as underwriter or dealer (unless lawfully directed by court order and Clause (3) prohibits the purchase by such bank's account as fiduciary from any member of the syndicate until the syndicate has closed as to underwriting. Here again, these proposed restrictions on fiduciary self-dealing by banks are no more comprehensive than those presently existing under the laws of many states -- laws to which banks are already subject. Moreover, these limitations do not assure elimination of the conflict of interest since it would be a simple matter for a bank to write special provisions into its trust agreements permitting purchases by its fiduciary accounts of revenue bonds it has underwritten and then obtain general approval by a court. Indeed, in view of the fact that various state statutes

*/ Pursuant to 12 U.S.C. §92a, a national bank, with the permission of the Comptroller of the Currency, may engage in trust and other fiduciary activities if, and to the same extent, state banks in the state where the national bank is located are authorized to do so. This section has been construed to mean that where a state bank is proscribed by state law from operating as a fiduciary in a particular manner, the exercise of fiduciary power by a national bank in the same state is co-extensively circumscribed. See, e.g., St. Louis County National Bank v. Mercantile Trust Co. National Association, 548 F.2d 716 (8th Ci., 1976), cert. denied, 433 U.S. 909.

expressly impose a general prohibition upon a bank as a fiduciary from purchasing securities or other property from itself, something of this nature must presumably be happening to enable banks lawfully to sell to their trust departments general obligations they have underwritten. In this regard, bank responses to the 1972 Antitrust Subcommittee questionnaire indicated that almost 25% of the fiduciary account purchases of general obligation bonds by the ten largest underwriting banks came from those banks themselves or from syndicates in which they were participating. On the other hand, if a bank is prevented from supporting its underwriting activities by trust purchases, a trust account would only be permitted to purchase in the after-market and thus might have to forego investment in a desirable issue or pay a premium if the issue is successfully marketed.

Clause (4) supposedly deals with conflicts of interest with depositors, borrowers and correspondents. The sole effort to resolve the conflicts of interest is to require a disclosure in writing that the bank is selling as an underwriter or a dealer. Obviously, such an indication on a confirmation slip for a security transaction offers no protection to customers who implicitly or explicitly must direct their business to an underwriting bank in order to maintain satisfactory access to credit and other relationships.

Clause (5) appears to be directed at the practice of a bank acting as an underwriter and at the same time purchasing bonds for its own investment account before the bonds are made available to the public. In a rising bond market, such a practice denies other investors -- non-underwriting banks, other institutional purchasers and individuals -- the right to buy at the initial public offering price. This bank abuse is in direct conflict with long-established fair trading practices in corporate underwriting enforced by the National Association of Securities Dealers. But Clause (5) does not prohibit insider preferences -- while a bank is prohibited from purchasing from its own underwriting account it is expressly permitted to purchase directly from the underwriting syndicate or from another member of the syndicate.

The final sentence of Section 1 of H.R. 1539 purportedly prohibits commercial banks from underwriting industrial revenue bonds. However, the term is defined as a bond "payable solely from rentals received by the issuer from private entities." Since many industrial revenue bonds are not payable from rentals at all, but are payable from proceeds of loans, installment sale agreements or guaranty arrangements, a bank would simply have to change the nature of the security arrangement in order to have underwriting authorization. By contrast, Section 103(b)(2) of

^{*/} See, e.g., N.Y. Banking Law §100-b (McKinney 1971); 6 Va. Code §1-24 (Supp. 1978).

the Internal Revenue Code has explicit and detailed provisions governing the definition of industrial development bond.

Finally, Section 2 of H.R. 1539 requires the Secretary of the Treasury to submit annual reports to Congress on the distribution of institutional business in underwriting and dealing in municipal bonds. It is difficult to see how submission of such a report would provide an adequate safeguard against bank domination of revenue bond underwriting and the consequential demise of many dealer firms. It is certainly wishful thinking to believe that Congress could respond in time to correct the harm done.

**TAX ADVANTAGES OF COMMERCIAL BANKS
IN UNDERWRITING MUNICIPAL BONDS AND
GOVERNMENT SECURITIES**

1. A bank which purchases tax-exempt securities with depositors' funds (which are federally insured) is nonetheless entitled to a deduction for interest paid on depositors' accounts, unless there are circumstances demonstrating a direct connection between the borrowing and the tax-exempt investment. A broker-dealer is not allowed a deduction for interest on indebtedness incurred or continued to purchase or carry tax-exempt securities.

Revenue Ruling 61-222, 1961-2 C.B. 58, states that, if a bank purchases tax-exempt securities with depositors' funds, it will nonetheless be entitled to a deduction for interest paid on depositors' accounts. Internal Revenue Code ("IRC") §265(2), which disallows a deduction for interest on indebtedness incurred or continued to purchase or carry tax-exempt securities, has no application to this state of facts because indebtedness to depositors is not, pursuant to the revenue ruling considered to be incurred or continued to purchase or carry tax-exempt securities.

Revenue Procedure 70-20, 1979-2 C.B. 499, provides additional guidelines in this area, stating that a deduction for such interest will be allowed unless there are circumstances demonstrating a direct connection between the borrowing and the tax-exempt investment. The revenue procedure states that a direct connection will ordinarily not be inferred in cases such as bank deposits, short-term notes, Eurodollar deposits, Federal fund transactions and the like. This principle of no direct connection is only a presumption which can be rebutted in the event of unusual facts and circumstances. In addition, interest paid or incurred on long-term indebtedness is also deductible if there is no direct connection to the tax-exempt investment.

In Revenue Procedure 72-18, 1972-1 C.B. 740, the Internal Revenue Service provided guidelines with respect to certain situations not covered by Revenue Procedure 70-20. It held that there is direct evidence of a purpose to carry tax-exempt obligations, thus requiring the application of §265(2), where such obligations are used as collateral for indebtedness. However, Revenue Procedure 78-34, 1978-2 C.B. 535, provides additional protection for banks by its conclusion that §265(2) has no application to bank borrowings of Treasury tax and loan funds which are secured by pledges of tax-exempt obligations, despite the rule set forth in Revenue Procedure 72-18.

In Revenue Procedure 80-55, 1980-2 C.B. 849, an attempt was made to cut back on the extent to which banks are effectively exempt from the application of §265(2). It concluded that banks which received time-deposits of state funds which were collateralized

with tax-exempt obligations would be subject to §265(2), resulting in non-deductibility of the interest paid on such deposits. This revenue procedure produced a furor among the nation's commercial banks, which mounted a campaign to oppose it. As a direct result of that opposition, Revenue Procedure 80-55 was revoked by the Internal Revenue Service in Revenue Procedure 81-16, 1981-17 I.R.B. 33. Mr. Chapoton at that time commented on the advantage thus provided commercial banks which might be considered in any Glass-Steagall review.

A broker-dealer is not allowed any deduction for interest on indebtedness incurred or continued to purchase or carry tax-exempt securities, under IRC §265(2).

Under Revenue Procedure 72-18, cited above, indebtedness incurred or continued for the general purpose of carrying on a brokerage business which includes the purchase of both taxable and tax-exempt obligations, where the proceeds of the borrowing cannot be directly traced, is treated as indebtedness incurred or continued to purchase or carry tax-exempt obligations in the same ratio that the brokerage's average portfolio of tax-exempt obligations bears to its average total assets during the taxable year. Interest on that part of the indebtedness is non-deductible under §265(2).

If bank dealers are able to underwrite all municipal revenue bonds the value of the deduction may well be substantially increased as will the benefits to the bank dealers with consequent additional cost to the Treasury.

2. A bank is permitted a deduction for the partial worthlessness of Section 165(g)(2)(C) securities, and may establish a reserve for bad debts related to such securities, claiming a deduction based upon a reasonable estimate of the portion of such securities which the bank determines will eventually be uncollectible. A broker-dealer is only permitted a deduction for such securities, upon a determination that they are totally worthless. Furthermore if such securities are held for investment, any gain or loss is considered to be capital in nature. IRC §1236. (Both IRC §582(c) and 1236 provide transitional rules, but such provisions are not pertinent to this analysis. IRC §582(c) is not necessarily an advantage for a commercial bank since although it may benefit from ordinary loss treatment upon the sale, at a loss, of a security held for investment, the rule would be detrimental upon the sale of the security at a profit.

IRC §582(a) provides that a commercial bank may take a deduction under IRC §166 (a) and (b) for the total or partial worthlessness of a security as defined in IRC §165(g)(2)(C). Reg. §1.165-5(a)(3) defines a Section 165(g)(2)(C) security as "a bond debenture, note or certificate, or other evidence of indebtedness to pay a fixed or determinable sum of money, which has been issued with interest coupons or in registered form by a

domestic or foreign corporation or by any government or political subdivision thereof." IRC S582(a) permits the establishment of a reserve for bad debts for a Section 165(g)(2)(C) security, allowing a deduction, under IRC S166(c), for a reasonable estimate of the portion of such securities which the bank determines will eventually be uncollectible. Such a reserve is in lieu of a bad debt deduction only for those specific securities definitively determined to be uncollectible.

A broker-dealer would only be permitted a deduction for a Section 165(g)(2)(C) security upon a determination that it is totally worthless. Reduction in value is recognized prior to such a determination only if the security is sold.

IRC S582(c) provides that the sale or exchange by a bank of a bond, debenture, note or certificate or other evidence of indebtedness will yield ordinary, not capital, gains and losses. A broker-dealer also recognizes ordinary gains and losses upon the sale of such securities, except that in the case of securities held for investment, any gain or loss is capital in nature. IRC S1236.

3. A bank is permitted, for taxable years beginning before January 1, 1988, to add to its reserve for bad debts on "eligible loans" by use of the percentage method, which may, depending upon a bank's actual loan experience, allow a bad debt deduction in excess of the bank's actual bad debt losses. A broker-dealer engaging in loan activity is limited to a bad debt deduction based upon its actual experience.

IRC S585 allows banks to add to their reserve for bad debts on "eligible loans" by using either the percentage method or the experience method. (Reg. S1.585-2 defines "eligible loans" as non-insured loans incurred in the course of normal customer loan activities, excluding loans which are functionally related to the trading or investment position of the bank or the maintenance or adjustment of its liquidity position. Section 165(g)(2)(C) securities are specifically excluded from the definition of "eligible loans" under the provisions of IRC S585.)

The percentage method, as opposed to the experience method, is not based on the bank's actual bad debt experience but allows the reserve to be maintained at a specified percentage of eligible loans, even if such percentage exceeds its actual bad debt losses. The allowable percentage at which the reserve may be maintained is 1.8 percent for taxable years beginning before 1976, 1.2 percent for taxable years beginning after 1975 but before 1982, 1.0 percent for taxable years beginning in 1982, and 0.6 percent for taxable years beginning after 1982 and before 1988. The percentage method is not available for taxable years beginning after December 31, 1987. The Senate Committee Report which accompanied the Tax Reform Act of 1969, in its discussion of IRC S585, stated that the average bad debt experience for banks for the previous six-year period had been 0.2 percent.

Senate Committee Report, 91st Congress, 1st Session, S. Rep. No. 91-552(1969)156. Use of the percentage method therefore may, in fact, depending upon a bank's actual experience, allow, for taxable years beginning before 1988, a bad debt deduction in excess of its actual bad debt losses. Arguments were made at the time of the consideration of ERTA that bad debt experience was higher but results would be the same, since the percentage method would be elected only if it is more beneficial than the experience method. Any such "excess" deduction is subject to the minimum tax on tax preferences under IRC §57(a)(7).

A broker-dealer who engages in loan activity, such as the making of margin loans, is limited to a bad debt deduction based upon its actual experience, under IRC §166(c). Cf. S.W. Coe & Co. v. Dallman, (CA-7) 54-2 USTC ¶9667.

4. The "All-Savers" provisions of ERTA gave the commercial banks a massive tax subsidy. If, as is estimated commercial banks issue \$150 billion of these certificates, the loss to the Treasury supporting the benefits to be gained by the commercial banks (which are generally not in financial difficulty as are the thrift institutions) could be as much as \$12 billion (Assume that \$150 billion would otherwise be raised by taxable certificates of deposit at, say, 16 percent, to taxpayers with marginal rates of between 30 and 50 percent:

\$150 billion x 16% x 50% = \$12 billion
 x 30% = \$7.2 billion).



SECURITIES INDUSTRY ASSOCIATION
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March 27, 1981

EDWARD I. O'BRIEN
President

The Honorable John G. Heimann
Comptroller of the Currency
490 L'Enfant Plaza, S.W.
Washington, D.C. 20219

Re: Tax-exempt, bank-underwriting-eligible revenue bond
issues supported by bank letters of credit

Dear Mr. Heimann:

We have noted the press reports of your staff's concern with the recently developed practice of supporting tax-exempt, bank-underwriting-eligible revenue bond issues with bank letters of credit. Having carefully followed the growth of the use of this device over the last year, the Securities Industry Association shares the concern of your office. We believe that the multiple roles of a bank in these situations providing key banking services and acting as a member of the underwriter group raise serious questions involving conflict of interests and unfair practices. While this letter does not address the soundness of this banking practice, we believe there may be questions to consider in that regard as well.

We support your thorough review of these transactions and urge you to initiate steps to prohibit multiple roles of banks in tax-exempt revenue bond financings, which now include underwriting the issue, providing a supporting letter of credit and providing investment contracts for funds pledged for the same bond issue.

The best way to illustrate our concern with the present situation is to relate the relevant features of a recent transaction as described in public disclosure materials. We have selected the recently-closed \$150,000,000 Brevard County Housing Finance Authority Single Family Mortgage Revenue Bonds Series 1980 B as a typical financing. Like the other major transactions using the letter of credit device which have been highly publicized, these revenue bonds were issued to finance mortgages on single family houses. The bonds were underwritten by a syndicate managed by Kidder, Peabody & Co. Incorporated, Southeastern Municipal Bonds, Inc., and Citibank, N.A.

Therefore, Citibank received a portion of the fees as a managing underwriter. In addition, Citibank had two more roles in this financing. It provided a "letter of credit" to fund payments to bondholders exercising certain rights to tender bonds for purchase. It also provided an investment agreement under which substantial amounts were to be invested at established interest rates over the term of the bond issue.

A small portion of the revenue bonds are stated to mature in the years 1982 through 1983. The balance of \$146,450,000 principal amount (the "Option Bonds") are stated to mature in 2013. Option Bonds which have not been redeemed are expected to be retired by mandatory sinking fund redemption from mortgage payments. Each Option Bond entitles the holder to tender his bond for purchase at par on annual principal payment dates commencing in 1986, if the bonds are not then in default. Although in form, the purchase is made on behalf of the Authority, the tender price is payable solely from drawings made on the letter of credit (after exhaustion of any available funds from mortgage payments and prepayments). Furthermore the Authority's obligation to reimburse the bank under this arrangement is strictly limited. The reimbursement obligation is secured solely by the bonds purchased with drawings under the letter of credit regardless of their then market value. They will be taken into inventory at par and not at their market price; since no marking-to-market requirement is applicable, the inventory of bonds purchased may well be overstated in value at the time of purchase. Bonds which have been tendered and purchased from amounts drawn under the letter of credit remain outstanding for all purposes. For example, they share the security for the bonds on a parity with all other bonds and are included with other Option Bonds in the random selection process for mandatory sinking fund redemption. The bank may retain or sell those bonds in satisfaction of the Authority's obligation. Retention or sale of the bonds appears to be the bank's exclusive source for reimbursement.

Citibank itself has acquired the right to exercise significant control over the Authority's program which relates to the letter of credit obligations. It can direct the bond trustee to sell off the pool of mortgages which secures the bonds and commence proceedings to redeem all bonds then outstanding at par. In this event, the bank is required under its letter of credit arrangement to provide only those funds which, together with the amount realized by liquidating the mortgage pool, is needed to redeem the bonds at par.

The bank receives a very substantial fee for providing the letter of credit. In the Brevard County Housing Authority financing, Citibank is to receive a semi-annual fee of .45% of the principal amount of Option Bonds Outstanding (more than \$1,310,000 annually prior to commencement of amortization of

Option Bonds). The bank also receives an additional fee, payable from amounts remaining under the indenture after all bonds are retired. This fee will constitute the present value, as of the date of actual payment, of a hypothetical stream of semi-annual payments. The discount rate to be applied is 8.993%. The hypothetical stream of payments represents the amounts which, if they had been added to each base fee payment, would have raised the base fee amount to .566% semi-annually. The actual amount of the fees paid under the program will, of course, depend principally upon mortgage prepayment experience. Based upon FHA mortgage prepayment statistics, the cumulative amount of the semi-annual base fee of .45% would exceed \$20 million. The termination fee would be payable in addition. (In contrast, the total underwriters' discount in this bond issue was \$3,750,000.)

The format for payment of letter of credit fees in the several financings undertaken to date has varied. A semi-annual fee is typical. Additional fees or termination fees are also typical. These may be paid "up-front" from bond proceeds or, after the bonds have been paid, from excess money. In each case, the amount of the fee has been substantial, far exceeding underwriting fees.

The third level of involvement by the bank is its investment contract with the bond trustee. Under that agreement, bond proceeds, reserve funds, mortgage revenues and excess moneys will be invested at specific rates in unsecured interest-bearing deposit accounts of or invested through the bank. Investor confidence in the feasibility of single family mortgage revenue bonds depends largely on income from investment of pledged funds. The structure of this type of bond issue is based on yield assumptions which are subjected to elaborate, independent verification procedures. The ability to show the potential investor a stable rate of return on the numerous investments which must be made from time to time over the 30-year life of a single family mortgage bond program, while at the same time assuring him that these investments will be secure undoubtedly aids the effort to market the new issue successfully. The purpose of the investment contract is to establish Citibank as a secure source of stable income in accordance with stated assumptions.

We believe that bank participation in these several roles raises significant issues which should be addressed. These issues can be grouped into two principal policy areas: (1) conflict of interests and (2) unfair banking practices.

Conflict of Interests

Each of the roles performed by the participant bank gives rise to a distinct set of interests. Conflicts between the bank's interests in one role and its interests in another role

could impair the bank's judgment as to important duties and create the perception of divided loyalties. Does a bank, acting as a managing underwriter with the potential of obtaining very large fees for providing a letter of credit, have an improper promotional stake in bringing issues to market? Three examples follow.

I. The relationship between the interest rate on the bonds and the probability that the bondholders will exercise their option rights creates conflicting interests. Once the security for a bond issue is established the underwriter and issuer must agree on the interest rates at which the bonds will be offered. Rates should bear a direct relationship to the compensation paid to the underwriter as a discount from the price of the bonds to the public. As the interest rates are reduced, the risks and effort involved in offering the bonds (and the value received by the issuer for the underwriter's compensation) are increased. However, if the bank is also the provider of the letter of credit, a factor which is extraneous to the relationship between the issuer and underwriter may influence the bank's decision to accept an interest rate for a given level of compensation. The bank is aware that bondholders are likely to exercise their option rights in the future only if the market provides alternative investments which bear a higher interest rate than the rate on the bonds. Thus, as the bond interest rates are increased, the probability that the bank will have to make payments under its letter of credit decreases. Because of the bank's interests under the letter of credit, it has a disincentive to work with the issuer to produce the best available interest rates for its bonds.

II. The mechanism for paying the letter of credit fees raises a difficult conflict of interests question. As described above, the fee has two components: (i) a semi-annual payment equal to a percentage of the outstanding option bonds, and (ii) an additional fee or termination fee in a stated amount, payable from bond proceeds or from any excess revenues after the bonds are paid. If the fee is to be paid prior to the retirement of the bonds (i.e., from mortgage payments, investment income or bond proceeds), it constitutes a use of revenues or revenue producing assets which would otherwise be available for payments to bondholders.

It is in the interest of the bank providing the letter of credit to have the fee paid from bond proceeds or, to a lesser extent, from mortgage revenues or investment earnings. The bank thereby receives its fee prior to the time all bondholders are paid. As a managing underwriter, however, the bank should negotiate for a workable financing which provides the issuer with the best available interest cost. To achieve this result, the underwriter should advocate a structure which provides security to the bondholders without impairing the issuer's ability to

fulfill its public purpose. The bank, as underwriter, should advocate payment from excess moneys, after the bondholders have been paid. Thus, in negotiating the allocation of the fee among bond proceeds, mortgage and investment revenues and excess funds, the interests of the bank providing the letter of credit and the bank as an underwriter are in conflict.

III. The managing underwriter also participates in structuring the business terms of a bond issue. It seeks to establish a set of rules for the financing and the issuer's operations which are practically workable while providing reasonable security to the bondholders as well. The underwriter should seek to balance flexibility for the issuer with reasonable control by the bond documents for the bondholders. After it is satisfied that the terms meet these standards, the underwriter assures itself that the issuer has fully disclosed the terms of the offering to the prospective bondholders.

The underwriter does not serve the interests of the issuer or the bondholders if the terms could result in technical defaults which are not material to the bondholders' prospects for payment. This could lead to serious consequences if the bond trustee believes that the documents give it no choice but to enforce the terms strictly. This kind of strict enforcement is not in the bondholders' primary interest - to be paid according to initial expectations.

The provider of the letter of credit has much different interests. The option cannot be exercised if the bonds are in default. The likelihood of the bank being called for payment under the letter of credit decreases each time a technical default is included in the terms of a financing. In the extreme case, it is not difficult to imagine a bank laying a minefield of defaults which could be used to postpone or avoid payments otherwise to be made under its letter of credit obligations.

Unfair Practices

The multiple involvement of the banks in these transactions as managing underwriter, provider of the letter of credit and provider of the investment contract presents the appearance that the banks' ability to provide credit services has been used to gain inclusion in the management group. The linkage of these banking services (the letter of credit and investment contract) with participation in the management group suggests unequal competition and inappropriate leverage.

Furthermore, a letter of credit in a transaction as large as the typical single family mortgage financing would be credible only if issued by a very large bank. The financing we chose as an example involves a potential exposure in excess of \$145,000,000. The magnitude of the fees which the banks have

been able to obtain has led to public speculation whether issuers have any opportunity to negotiate freely or whether a monopoly or near monopoly situation exists. If these transactions are limited to only a few banks, and if the letter of credit format is important to gaining access to investors in today's turbulent bond markets, the potential leverage of the banks which are capable of providing a letter of credit is imposing. The results could include unfair pricing of the fee as well as a linkage of unwanted services, such as underwriting and an investment contract, to the letter of credit.

Finally, playing all three roles gives the very large banks an opportunity to use the level of compensation for each individual service to foreclose competition because of the enormous leverage it gains from providing a letter of credit. Each of the services could be provided separately just as efficiently. If, however, a bank were assured of selection for the letter of credit role, it could also assure itself of the investment contract position by reducing its required compensation for the investment contract while increasing the letter of credit commission. It could do the same with respect to the managing underwriter fees. The potential for such manipulation is inescapable where the banks offer these discrete services as a package or where providing one service (i.e., the letter of credit) is conditioned upon getting, or used to get, the other business.

It is premature to suggest that any of these arrangements involves criminal violations under the federal antitrust laws such as 12 U.S.C. § 1972. We are not privy to all of the facts surrounding the negotiation of these financings. Nevertheless, it is clear that the Comptroller should not be confined to the technicalities of the antitrust laws in seeking to eliminate actual or threatened predatory practices and situations in which unfair advantage is inherent.

The appearance of linkage between banking services demands further inquiry. Congress has clearly stated a policy that the market for banking services should be freely competitive. The Comptroller of the Currency should further this policy by careful scrutiny of these banking arrangements both to identify violations of existing laws as well as to identify appropriate subjects for new regulation.

Furthermore, by its recent amendment of Section 18 of the Federal Trade Commission Act to extend its controls to banks, Congress has adopted a policy that unfair or deceptive acts or practices by banks should be prohibited. The situation described and other similar situations should be carefully reviewed by you to determine if this policy is being fulfilled.

We request that you give immediate attention to these serious questions of conflict of interests and unfair practices. We believe the only workable solution is to separate underwriting services completely from banking services. If a bank provides a letter of credit in a transaction it should not also serve as an underwriter.

Sincerely,

SECURITIES INDUSTRY
ASSOCIATION

Edward I. O'Brien,
President



**MUNICIPAL FINANCE COMMITTEE
SECURITIES INDUSTRY ASSOCIATION**

90 L'Enfant Plaza East, S.W., Washington, D.C. 20024 • (202) 488-4864

Appendix D

October 16, 1981

WALTER W. CRAIGIE, JR., Chairman
Wheats, First Securities, Inc.
CHARLES A. BALLARD, Vice Chairman
Dillon, Read & Co., Inc.
S. David Antisberger
Underwood, Naurous & Co., Incorporated
Alan G. Arnold
Hewlett, Hill, Labourer, Friedrichs Incorporated
Thomas M. Ayres
Cumberland Securities Company, Inc.
David H. Bingham
Am. C. Roney & Co.
Gerald S. Brenzel
Solter, Nicosius & Company, Incorporated
S. E. Canaday, Jr.
John Hansen & Co., Incorporated
Richard F. Carlson
Carlson & Co., Inc.
Harold W. Clark
The Cherokee Securities Company
Walter L. Cole
Secoreff, Cole & Co.
Kevin J. Collins
The First Boston Corporation
William P. Deegan
L. P. Rothchild, Unterberg, Towbin
Brian C. Donald
Bache-Halsey Stuart Shields Incorporated
Robert H. Downey
Goldman, Sachs & Co.
Michael J. Endres
The Chie Company
Clifton L. Fennell
Kudler, Peabody & Co., Incorporated
Walter W. Fitts
Van Kampen Fitts & Merritt Inc.
Nathaniel T. Frazer
The Frazer Lamer Corporation Incorporated
Cecil M. Fritz
City Securities Corporation
William F. Fuller
Reese Madsen Inc.
Charles S. Garland, Jr.
Alex. Brown & Sons
Vernon J. Gies
Stephens Inc.
Milton Halpern
Rauscher Pierce Refsnes, Inc.
Bruce E. Haney
Piper, Jaffray & Hopwood Incorporated
Joseph A. Harman
Lehman Brothers Kuhn Loeb Incorporated
Louis A. Haudoffersich
Smith Barney, Harris Upham & Co., Incorporated
Harold B. Kluckhohn
Dean Witter Reynolds Inc.
Roger W. Leaf
Morgan Stanley & Co., Incorporated
Robert R. Martin
Dain Bosworth Incorporated
Bernard J. Mikali, Jr.
Sutro & Co., Incorporated
Thomas H. Mitchell
J. C. Bradford & Co.
Daniel R. Murphy
S. F. Hunter & Company Inc.
Stanley T. Pardo
Byth Eastman Pardo Webster Incorporated
George L. Partlow
J. J. B. Millard W. L. Lyons, Inc.
Rowland A. Radford
The Robertson-Humphrey Company, Inc.
Jean J. Rousseau
Merrill Lynch White Weld/C.M.G.
W. G. Smith
Burrows, Smith & Co.
John B. Tamagni
Lillard Frenn & Co.
King R. Traub
Traub and Company, Inc.
Eugene C. Trems
Merrill & Company
Francis H. Trembley, Jr.
First Albany Corporation
David H. Troop
Shearson Loos Rhoades Inc.
Kevin E. Troiman
Boettcher & Company
Carl B. Watson Jr.
Interstate Securities Corporation
Victor M. Zahner
Zahner and Company
Thomas J. Ziegler
Butcher & Singer Inc.

BY MESSENGER

Hon. Donald T. Regan
Secretary of the Treasury
Room 3300, Department of the Treasury
15th and Pennsylvania Avenues, N.W.
Washington, D.C. 20220

Dear Mr. Secretary:

Title III of S.1720, the bill with respect to which you are scheduled to testify on Monday, October 19, would amend the Glass-Steagall Act to permit commercial banks to underwrite all municipal revenue bonds (except industrial revenue bonds). This proposal is substantially similar to legislation proposed over the last several years by the Dealer Bank Association. We urge you to recommend to the Senate Banking Committee that the question of commercial bank underwriting of municipal bonds be taken up in the context of a full review of Glass-Steagall, which Chairman Garn has publicly indicated will take place early next year. We support such a review.

As you know, we in the securities industry live by competition. We are not opposed to anyone entering our business as long as we all stand on a level playing field, not one filled with potholes. Unfair competition can destroy our industry. Particularly affected will be the smaller and regional broker-dealers, which a joint study by the Securities and Exchange Commission and the Small Business Administration indicates will be forced out of business or to merge as a result of this change in Glass-Steagall. States, cities and towns as well as small businesses everywhere in need of venture capital assistance will be the losers from the demise of regional and smaller broker-dealers.

The rules that apply to banking and the securities business are complex. The relationships are intricate. The Glass-Steagall Act, a

NEW YORK OFFICE: 20 Broad Street, New York, N.Y. 10005 • 212 425-2700

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October 15, 1981
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major piece of legislation adopted by Congress fifty years ago, has served this country very well by providing true alternative capital formation markets for American business. Yet the large commercial banks, who will be the principal beneficiaries of this change, are proposing to dismantle the Glass-Steagall Act on a piecemeal basis, starting first with the underwriting of municipal revenue bonds. As you are probably aware, H.R. 4040, which has also been filed this session in Congress, would permit commercial banks not only to underwrite all municipal revenue bonds, but to deal in corporate debt securities with other securities activity to follow.

We are opposed to any piece-by-piece dismantling of Glass-Steagall. We feel that if Congress decides it is in the national interest to review the relationships between commercial banks and the securities industry it should review them in the entirety, the Glass-Steagall Act and the other laws covering the relationship between commercial banks and securities firms and the competition between them. If banks are going to be able to invade our industry, they should only be able to do so on even competitive terms.

There is no urgency to the consideration of this matter at this time. The commercial banks are quite profitable currently in their domestic banking operations. There is no benefit to the municipalities as claimed by the large commercial banks. Also, such a move might well cost the U.S. Treasury many millions of dollars. These are the facts:

1. The large commercial banks claim hundreds of millions of dollars of savings to municipal issuers if they are allowed to underwrite all municipal revenue bonds. This claim is untrue and was disproven in 60 hours of hearings before the House Banking Committee's Subcommittee on Financial Institutions in 1979.
2. Commercial bank entry into the underwriting of all municipal revenue bonds will decrease competition because

Donald T. Regan
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the special advantages banks have ultimately will drive securities firms out of business. The SEC and SBA have issued a thoughtful two-part report supporting this conclusion. The equity markets as well as the municipal bond market will suffer from this shrinkage in the distribution system.

3. If commercial banks are allowed to underwrite all municipal revenue bonds the U.S. Treasury could well lose many millions of dollars. Banks will then be able to deduct from their taxable income the carrying costs on all municipal revenue bonds, something securities firms cannot do.
4. Such a step will concentrate even more economic power in the major commercial banks of this country.

We in the securities business are proud of the job we are doing to help raise capital for municipal issuers and American businesses in these extraordinary times. The genius of the American financial system is that we do not have only one place to go for capital as is the case in some countries such as Germany. Here in this country there is a choice and the efforts of the large commercial banks to accumulate economic power will inevitably eliminate these choices from the American scene. We do not think that that development is in accord with the American spirit of diversity. We hope you agree.

If there is to be change, let it be done in a thoughtful and considered manner. Any change must provide for the level playing field essential to fair competition. We hope the Administration agrees and that you will urge the Senate Banking Committee to defer consideration of the question of revenue bond underwriting by commercial banks until all of these complex issues can be considered together.

Donald T. Regan
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Enclosed are materials which we have prepared
for your review and consideration.

Sincerely yours,

S/

Ralph D. DeNunzio
Chairman of the
Board, Securities
Industry Association

S/

Edward I. O'Brien
President, Securities
Industry Association

S/

Walter W. Craigle, Jr.
Chairman, Municipal
Finance
Committee

cc: John Chapoton
Roger W. Mehle, Jr.
Roger B. Porter

**SOME SIGNIFICANT ADVANTAGES OF COMMERCIAL BANKS
OVER SECURITIES FIRMS
TO BE TAKEN INTO ACCOUNT TO ACHIEVE A
"LEVEL PLAYING FIELD"**

1. Tax Advantages of Commercial Banks

A. Deductions

- Deductibility of interest in the cost of carrying tax-exempt inventory.
- Partial worthlessness of certain (Section 165(g) (2) (C)) securities may be deducted and a reserve may be established for bad debts related to such securities by deduction.
- Additions to loan loss reserves may be made by percentage method; more favorable than experience method permitted securities firms.

B. Tax brackets are effectively lower due to, e.g., ability to utilize foreign tax credits and tax-exempt income.

C. All-Savers legislation has granted enormous tax benefits (possibly up to \$12 billion) to commercial banks to enhance their profitability, net assets and cash flow.

2. Economic Power of Commercial Banks

A. Banks accept deposits (each account has federal insurance) for use in their own business.

B. Lower cost of capital (securities firms borrow from banks at market rates).

- Federally-insured deposits and certificates at below-market cost (benefits of Regulation Q and All-Savers).
- Access to Federal Funds markets.
- Access to Federal Reserve discount window.

C. Banks have Captive Markets

- Trust Accounts (Direct control)
- Own Investment Accounts (Direct control)
- Correspondent Banks (Indirect control)

- D. Multiple Relations with Tax-Exempt Issuers (with consequent problems of conflict of interest and intimidation)
 - Depository for public funds (much of which is federally insured)
 - Trustee
 - Paying Agent
 - Often primary short-term lender to municipalities; banks lend, securities firms can only help raise, money
 - Investor
 - E. Can tie in package of credit services - short-term loans, letters of credit, lines of credit as an inducement or requirement to become a manager in underwriting situations.
 - F. Bond inventory not required to be valued at true market value, carried at cost; inflates asset value, permits holding of securities for extended periods because no losses recognized short of sale; and avoids profits by placement in own investment account. Securities firms must mark to market daily for regulatory purposes and cannot avoid the recognition of profit and loss in any transaction.
3. Regulatory Advantages of Commercial Banks in Securities Activities
- Exempt from registration requirements of Securities Act.
 - Not subject to supervision of SEC.

October 15, 1981

PROBLEMS WITH CONSIDERATION OF
PERMITTING COMMERCIAL BANKS
TO UNDERWRITE MUNICIPAL REVENUE BONDS
AS PROPOSED IN S.1720 TITLE III

Banks enjoy significant competitive advantages over nonbank underwriters - lower cost of capital, tax deductibility of carrying costs and captive markets, to name the principal ones - making competition between the two groups inherently unfair.

Commercial banks have sought legislation to permit them to extend their activities further into the securities business almost since the time of the adoption of the Glass-Steagall Act in 1933. The question raises extremely complex issues and, thus far, Congress has not decided to permit this extension of bank activity because there are no compelling reasons to do so and many compelling reasons why no change should be made, particularly the special advantages enjoyed by commercial banks. In 1979, the Financial Institutions Subcommittee of the House Banking Committee spent 60 hours in hearings considering the claims by commercial banks that very substantial savings to municipalities would result from their entry into the underwriting of all municipal revenue bonds. Those claims were thoroughly disproved and the matter not even taken to a vote in the Subcommittee.

There are many who feel that the Glass-Steagall Act itself should be reconsidered and the securities industry supports such a review. Senator Garn indicated at the time of filing S.1720 that the Glass-Steagall Act would be reviewed in early 1982. However, Title III of S 1720 would allow commercial banks to underwrite all municipal revenue bonds (except industrial revenue bonds), which is a major change in Glass-Steagall. We believe that such a major change should only be done in the context of a full review of Glass-Steagall so that the significant public policy issues underlying that legislation can be thoroughly considered. Also, at that time the interests of all who are affected by Glass-Steagall, securities firms as well as commercial banks, and the many people in this country who benefit from the dual capital formation system, may be considered. The immediate problems of the thrift institutions addressed by S.1720 do not involve revenue bond underwriting by commercial banks. The commercial banks are not in trouble. They are experiencing, in general, quite profitable times. There is no urgency to the consideration of this matter. Because of the complexity of these issues we have urged upon Senator Garn that Title III be separated from S.1720 and considered next year in his Committee's review of the Glass-Steagall Act. If a change is to be made, rules for a level playing field must be provided.

The effects of this anti-competitive legislation permitting commercial banks to underwrite all municipal revenue bonds while still retaining their special advantages will be the following:

1. Unfair competition due to their unique advantages ultimately resulting in the domination of the tax-exempt securities business by banks (just as they would inevitably dominate grocery or newspaper businesses if they were allowed to enter those fields with their special advantages intact).
2. Fewer securities firms to serve the capital needs of Amer can small businesses and municipalities. The Securities and Exchange Commission and the Small Business Administration in two joint studies (1979 and 1981) expressed concern for the shrinkage in smaller and regional securities firms which would result if banks are allowed to underwrite all municipal revenue bonds. ("Initial Public Offerings of Common Stock: The Role of Regional Broker-Dealers in the Capital Formation Process"; The Role of Regional Broker-Dealers in the Capital Formation Process: Underwriting, Market Making and Securities Research Activity.")
3. Less competition for tax exempt issues and assistance for small businesses as bank domination eliminates regional and smaller securities firms which have often played key roles in venture capital and new technology situations.
4. The benefits of this legislation will be enjoyed principally by the biggest commercial banks in America.
5. More economic power will be concentrated in the handful of large commercial banks in this country who are the beneficiaries of this change.
6. Destruction of the diversity provided by the dual capital formation system in this country, by the commercial banks on the one hand and other financial institutions, principally securities firms, on the other. The present financial system, unlike Germany, gives one seeking capital more than one place to go.
7. Commercial banks, in one of their most profitable periods in history, will have been granted a new area in which they can compete unfairly and eventually dominate, all to their further profit. Next, corporate securities, farming, health care?
8. The elimination of the diversity of our financial markets will risk the loss of the invention and innovation which has characterized the securities industry.

9. The savings for tax-exempt issuers claimed by the banks will not materialize. Numerous studies have disproved those claims. If commercial banks really intend to pass on the "savings" from their special advantages to the tax-exempt issuers of revenue bonds, why haven't they done that already in the general obligation or housing fields? With their lower cost of capital and the deductibility of carrying costs, banks could easily outbid securities firms 100% of the time, not 50%. It's clear: those "savings" are kept as profits and not passed on. Why think they'll be different in the future? Their record suggests otherwise.
10. At a time when extra revenues are being sought, the U.S. Treasury may well lose millions and millions of dollars when banks can deduct the interest costs of carrying their inventories of all municipal bonds, not just general obligation bonds.
11. The potential for conflicts of interest arising from economic pressure, tie-ins, multiple relationships will sharply increase.

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The CHAIRMAN. Thank you.

Mr. Schneider, we are happy to have you with us today, and if at a later date you want to bring in some professors to say that your testimony is true, we will allow you equal professors to do that.

Mr. SCHNEIDER. I will try to handle the arguments myself.

The CHAIRMAN. If you would proceed.

STATEMENT OF HOWARD M. SCHNEIDER, PRESIDENT, DEALER BANK ASSOCIATION

Mr. SCHNEIDER. Mr. Chairman, Senator Dixon, I will be speaking from my oral statement delivered to the committee this morning, rather than the earlier statement, because we have now been able to address in a preliminary way the Monday testimony by Secretary Regan.

The Dealer Bank Association deeply appreciates the invitation of this committee to participate in these very significant hearings. We are particularly pleased to be able to comment on section 301 of S. 1720, which contains provisions identical with S. 1427, the bill introduced by Chairman Garn and Senators Proxmire and Lugar, which authorizes commercial banks to underwrite and deal in public purpose revenue bonds.

You may remember in May, Mr. Philip Sweet, chairman of Northern Trust Co. of Chicago, also testified in favor of this bill. We are delighted that you, Mr. Chairman, have decided to include those provisions in your omnibus legislation and we are pleased that companion legislation, H.R. 2828, introduced in the House of Representatives by Congressman Lundine and Bernard, now enjoys the cosponsorship of 212 Members of the House of Representatives.

ADDED COMPETITION WILL REDUCE INTEREST COSTS

In the view of the association, the principal public policy reason for congressional enactment of this authority is that the added competition among underwriters and the participation of commercial banks in the marketing and trading of municipal revenue bonds will reduce interest costs for State and local governments and their taxpayers. This fiscal benefit will be achieved without the expenditure of additional Federal funds.

We believe that permitting commercial banks to underwrite and trade in municipal revenue obligations are thoroughly consistent with the intent of the Glass-Steagall Act, particularly its authorization of public securities activities by banks. Moreover, this amendment to the Glass-Steagall Act is completely in harmony with 16 other amendments in the past five decades which have permitted commercial banks to underwrite and deal in securities of such public institutions as Fannie Mae, Tennessee Valley Authority, and the Asian Development Bank.

The obvious purpose is to provide for these public securities the broadest and most competitive markets possible. The benefits of these same competitive markets needs to be extended to municipal revenue obligations which now account for 70 percent of long-term State and local borrowing; 50 years of competitive experience in the general obligation bond area where broker dealer firms and commercial banks have both competed and cooperated with each other makes it clear that the public benefits of bank competition can be obtained for state and local governments, while at the same time inflicting no commercial injury on the financial health of broker dealer firms.

On the opening day of these hearings, Secretary Regan presented the view of the administration. The Dealer Bank Association is highly gratified that the administration has endorsed bank entry into the municipal revenue bond underwriting and trading business. The formal endorsement continues in the tradition of strong support for bank participation in the revenue bond market by public officials at all levels of government of both political parties over many years.

The Treasury statement indicated, however, that commercial banks should establish a separately capitalized bank holding company subsidiary for underwriting and trading not only in municipal revenue bonds but in general obligations bonds and U.S. Government securities as well. We have not seen the details of the proposal, of course; and we have had only a few days to consider it.

Our initial analysis leads us to be concerned about the possible adverse effects of the proposal on banks and on public securities issuers including the U.S. Government. I will describe briefly some of the reasons for our concern.

First, the establishment of a subsidiary of a bank holding company, necessarily involves legal and accounting work and time consuming regulatory processing and approval, all of which can create significant startup costs and continuing administrative expenses.

Second, requiring the establishment of a holding company subsidiary for all of a bank's public securities activities may also increase costs by forcing the inefficient utilization of a bank's capital. Cre-

ation of such a subsidiary means that some portion of bank capital will have to be partitioned and allocated to this limited mission, and will thus not be available for periodic utilization for other investment, trading, and lending activities. Likewise, such a structural arrangement would undoubtedly make it more difficult to deploy capital quickly when additional capital is needed to meet major Federal or municipal demands on the public securities market.

Third, we are not persuaded at this time by the reasons Treasury has given to support the separate subsidiary idea. One of their reasons, as we understand it, is to achieve equal regulation between bank dealers and nonbank broker/dealer firms. But the plain fact is that today we already have equal regulation. Both categories of public securities dealers are subject to the regulatory requirements established by the Municipal securities Rulemaking Board comprised of representatives of the public, of broker/dealers and of banks. The MSRB is subject to the oversight of the Securities and Exchange Commission, and no rule can go into effect without that agency's express approval.

Another point made by Treasury is that there might be linkages between traditional banking services and bank securities activities. But there is no industry in the country that is subject to more stringent antitying laws than the banking industry. In fact, no evidence has ever been presented to suggest that banking organizations are guilty of tying arrangements in their municipal securities activities.

Arguments that federally insured deposits should be protected from the special risks involved in public securities underwriting and trading is very surprising. Revenue bond legislation has been the subject of hearings in this committee and other committees of the Congress over the past 15 to 20 years. On none of those several occasions has any Federal bank regulatory authority, or any representative of the Treasury suggested that the public securities activities of commercial banks now ongoing for 50 or 60 years or more, produced any unique or significant risks to the safety and soundness of the banking system.

Similarly, we are surprised at the Treasury's reference to apparent differences in the cost of funds as having any competitive significance in the public securities business. In the underwriting process, a syndicate commits to buy bonds from the issuer and then resell them to the public on a when-issued basis several weeks before the actual cash settlements take place. Thus, as a practical matter, no securities need to be carried in inventory in the underwriting process and the cost of funds does not come into play at all. Securities are carried in inventory for secondary market trading, of course, but as the securities industry's own economist has recognized, banks today have to buy their funds and their marginal cost, like that of broker dealers, is determined by the market.

EQUIVALENT TAX TREATMENT

That brings me finally to the question of equivalent tax treatment. It is true that under some circumstances broker dealers can suffer a disallowance of the interest incurred to carry tax exempt

bond inventories. This has no effect on the underwriting process, for reasons I have already described. Even with respect to secondary market activities, analysis may show that the disparity is more apparent than real. We know, for example, that in the bank-eligible municipal markets, there has been a longstanding practice of establishing joint accounts or syndicates between banks and broker dealers for the sharing of risks and the joint distribution of securities. In these joint accounts, the banks share with broker dealers whatever benefits may be available from the tax treatment of bank funding costs.

Also, it appears that many broker dealer firms have organized their affairs to provide that the carrying of all or a portion of a tax-exempt inventory is allocated to non- or low-interest cost funds such as equity capital. Let us also remember that the ultimate impact of the theoretical tax disparity clearly will vary, depending on relative effective income tax rates of various banks and various broker/dealers. The fact is there has been no indepth analysis of the financial and competitive implications of the income tax treatment of bank dealers and nonbank dealers.

To the extent that the information for such analysis is available, the Treasury Department has the data. It would be helpful if Treasury undertook a comprehensive and detailed analysis of the issue. If an authoritative study shows that there is a significant financial advantage actually achieved by bank dealers, than unquestionably, that disparity should be removed. For the benefit of the State and local government issuers of municipal obligations, we believe that equity should be achieved by affording to broker dealer firms the same tax treatment which is available to banks.

We do not believe that action on the authority for commercial banks to underwrite the revenue bonds should await the completion of such a study. Whether or not we find a quantifiable difference in carrying costs, by reasons of differences in tax treatment, it is abundantly apparent from the empirical record of competition in the GO market, over 30 years, that this difference has had no material impact on competition between banks and broker dealer firms. For these reasons, our initial analysis leads us to think that the Treasury's suggestion of a separately capitalized subsidiary may be unnecessarily cumbersome, as well as disadvantageous for Federal and municipal issuers.

This is especially so in light of the nature of the additional underwriting authority involved. After all, what we are talking about is updating the law to reflect the changes that have taken place in State and local finance, and simply to restore the ability of banks to compete fully in the municipal securities market.

The compelling public need, as you probably will hear from the next panel, is to bring to State and local government the benefits of the broadest possible competition for underwriting their revenue bonds without further delay. We should not let a debate about the mechanics deflect us from that goal.

Thank you very much for this opportunity of the Dealer Bank Association to present its views.

I would be pleased to answer any questions from the committee.
[Complete statement follows:]

ORAL STATEMENT OF HOWARD M. SCHNEIDER,
PRESIDENT OF THE DEALER BANK ASSOCIATION,
BEFORE THE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
OCTOBER 22, 1981

Mr. Chairman, the Dealer Bank Association deeply appreciates the invitation of this Committee to participate in these very significant hearings. We are particularly pleased to be able to comment on Section 301 of S.1720, which contains provisions identical with S.1427, a bill introduced by Chairman Garn and Senators Proxmire and Lugar, which authorizes commercial banks to underwrite and deal in public-purpose revenue bonds.

We are delighted that you, Mr. Chairman, have decided to include those provisions in your omnibus legislation, and we are pleased that companion legislation, H.R. 2828, introduced in the House of Representatives by Congressman Stanley Lundine and Douglas Barnard now enjoys the cosponsorship of 211 Members of the House of Representatives.

In the view of the Association, the principal public policy reason for Congressional enactment of this authority for commercial banks is that the added competition among underwriters and the participation of commercial banks in the marketing and trading of municipal revenue bonds will have the effect of reducing interest costs for state and local governments, and their taxpayers, and this fiscal benefit will be achieved without the expenditure of additional Federal funds.

We believe that permitting commercial banks to underwrite and trade in municipal revenue obligations is thoroughly consistent with the intent of the Glass-Steagall Act, particularly its authorization of public securities activities by banks. Moreover, we believe that this amendment to the Glass-Steagall Act is completely in harmony with sixteen other amendments over

the past five decades which have permitted commercial banks to underwrite and deal in securities of such public institutions as the Federal National Mortgage Association, the Tennessee Valley Authority, and the Asian Development Bank. The obvious purpose is to provide for these public securities the broadest and most competitive markets possible. The benefits of these same competitive markets need to be extended to municipal revenue obligations, which now account for 70 percent of long-term state and local borrowing. Fifty years of competitive experience in the general obligation bond area, where broker/dealer firms and commercial banks have both competed and cooperated with each other, makes it clear, beyond any reasonable doubt, that the public benefits of bank competition can be obtained for state and local governments, while at the same time inflicting no commercial injury on the financial health of broker/dealer firms.

On the opening day of these hearings, Secretary Regan presented the view of the Administration. The Dealer Bank Association is highly gratified that the Administration has endorsed bank entry into the municipal bond underwriting and trading business. This formal endorsement by the Administration continues in the tradition of strong support for bank participation in the revenue bond market by public officials at all levels of government, of both political parties, for many years.

The Treasury statement indicated that commercial banks should establish a separately capitalised bank-holding-company subsidiary for the underwriting and trading not only in municipal revenue bonds, but in general

obligation bonds and U. S. government securities as well. We have not seen the details of the proposal, of course, and we have had only a few days to consider it. Our initial analysis leads us to be concerned about the possible adverse effects of the proposal, particularly on public securities issuers, including the United States government. I will describe briefly some of the reasons for our concern, all of which, we think, warrant further study and discussion.

First, the establishment of a subsidiary in a bank holding company necessarily involves legal and accounting work and time-consuming regulatory processing and approvals, all of which can create significant start-up costs and continuing administrative expenses.

Second, requiring the establishment of a holding-company subsidiary for all of a bank's public securities activities may also increase costs by requiring the inefficient utilization of a bank's capital. Most financial managers will agree that capital should be deployed broadly to support a wide variety of asset and funding requirements. If kept in the bank, capital can be moved quickly and efficiently in response to changing asset demands and changing market requirements, which is particularly important under today's volatile economic conditions. Creation of a holding-company subsidiary for public securities activities means that some portion of bank capital will have to be partitioned and allocated to this limited mission and will thus not be available for periodic utilization for other investment, trading and lending activities. Likewise, such a structural arrangement would undoubtedly make it more difficult to deploy capital quickly when additional capital is needed to meet major Federal or municipal demands on the public securities market.

Third, we are not persuaded at this time by the reasons Treasury has given to support the separate subsidiary idea.

One reason, as we understand it, is to achieve equal regulation between bank dealers and nonbank broker/dealer firms. But the plain fact is that today we already have equal regulation. Both categories of public securities dealers are subject to the regulatory requirements established by the Municipal Securities Rulemaking Board, a tripartite rulemaking body comprised of representatives of the general public, representatives of the broker/dealer business and representatives of the bank dealer business. The MSRB is subject to the oversight of the Securities and Exchange Commission. Indeed, no rule can go into effect without the express approval of the SEC.

In the case of nonbank dealers, compliance with the rules of the MSRB is monitored by the National Association of Securities Dealers, the securities industry's self-regulatory agency. In the case of bank dealers, compliance with the MSRB rules is monitored by the three Federal banking agencies through their professional examination staffs and includes periodic specialized examination of dealer operations. This is the regulatory scheme Congress adopted in the Securities Acts Amendments of 1975, and it has worked just fine. Thus, both in theory and in practice, there are no disparities or inequities in terms of the regulation of these two categories of public securities dealers.

Another point made by Treasury is that there might be linkages between traditional banking services and bank securities activities. But there is no industry in the country that is subject to more stringent anti-tying laws than the banking industry. These laws are vigorously monitored and enforced by the bank regulatory agencies. In fact, no evidence

has ever been presented to suggest that banking organizations are guilty of tying arrangements in their municipal securities activities. In any event, if there were a disposition on the part of a bank manager to run the enormous risks involved in engaging in unlawful tying activities, he would surely not be dissuaded by the fact that the securities activities were in a bank-holding-company affiliate.

Treasury's argument that Federally insured banking activities should be protected from the special risks involved in public securities activity is very surprising. Revenue bond legislation has been the subject of hearings in this Committee and in other committees of the Congress over the past 15 to 20 years and on none of those several occasions has any Federal bank regulatory authority or any representative of the Treasury Department suggested that the public securities activities of commercial banks, now ongoing for some 50 years, produce any unique or significant risks to the safety and soundness of the banking system.

Similarly, we are surprised at the Treasury's reference to apparent differences in the cost of funds as having any competitive significance in the public securities business. In the underwriting process, the syndicate commits to buy bonds from the issuer, and then resells them to the public on a "when-issued" basis several weeks before the actual cash settlements take place. Thus, as a practical matter, no securities need to be carried in the underwriting process, and the cost of funds does not come into play at all. Securities are carried in inventory for secondary market trading, of course; but as the securities industry's own economist has recognized, banks today have to buy their funds, and their marginal cost, like that of broker/dealers, is determined by the market.

That brings me, finally, to the question of equivalent tax treatment. It is true that under some circumstances broker/dealers can suffer a disallowance of the interest incurred to carry tax-exempt bond inventories. This has no effect on the underwriting process, for reasons I have described. Even with respect to secondary market activities, analysis may show that the disparity is more apparent than it is real. We know, for example, that in the bank-eligible municipal markets there has been a longstanding practice of establishing joint accounts between banks and broker/dealers for the sharing of market risk and joint distribution of securities. In these joint accounts banks share with broker/dealers whatever benefits may be available from the tax treatment of bank funding costs. Also, it appears that many broker/dealer firms have organized their affairs to provide that the carrying of all or a portion of a tax-exempt inventory is allocated to non- or low-interest cost funds such as equity capital. Moreover, the relative impact of the theoretical tax disparity clearly will vary depending on relative effective income tax rates of various banks and broker/dealers.

The fact is that there has been no in-depth analysis of the financial and competitive implications of the income tax treatment of bank dealers and nonbank dealers. To the extent that the information for such analysis is available, the Treasury Department has the data. It would be helpful if Treasury undertook a comprehensive and detailed analysis of the issue.

If an authoritative study shows that there is a significant financial advantage accorded to bank dealers, then, unquestionably, that disparity should be removed. For the benefit of the state and local government issuers of municipal obligations, we believe that equity of treatment should be achieved by according to broker/dealer firms the same tax treatment which is available to banks.

In urging that the Treasury undertake such an analysis, we wish to make it indelibly clear that we do not believe that action on the authority for commercial banks to underwrite revenue bonds should await the completion of such a study. Whether or not we find a quantifiable difference in carrying costs by reason of differences in tax treatment, it is abundantly apparent from the empirical record of competition in the general obligation market that this difference has had no material impact on competition between banks and broker/dealer firms.

For these reasons, our initial analysis leads us to think that the Treasury suggestion of a separately capitalized subsidiary may be unnecessarily cumbersome, as well as disadvantageous for Federal and municipal issuers. This is especially so in light of the nature of the additional underwriting authority involved. What we are talking about, after all, is updating the law to reflect the changes that have taken place in state and local finance and simply to restore the ability of banks to compete fully in the municipal securities market. The compelling public need, as you will hear in more detail from the next panel, is to bring to state and local governments the benefits of the broadest possible competition for underwriting their revenue bonds without further delay. We should not let a debate about the mechanics deflect us from that goal.

Thank you.

The CHAIRMAN. Thank you, Mr. Schneider.
Mr. Kremer?

**EDWARD J. KREMER, MEMBER, INDEPENDENT INSURANCE
AGENTS OF AMERICA, ACCOMPANIED BY TOM WILSON**

Mr. KREMER. Thank you. I am Edward Kremer, president of Hanna & Kremer Insurance Agency. I am accompanied by our Washington counsel, Mr. Thomas Wilson.

The remarks I offer today are made on behalf of not only IIAA but also the Major Insurance Producers Association of the United States, including the National Association of Professional Insurance Agents, National Association of Life Underwriters, and the National Association of Casualty and Surety Agents.

We understand the enormous complexity of this legislation and the far-reaching changes the bill would engender in the way financial services are organized and distributed. You have undertaken a difficult and laudable task.

We will attempt this morning to focus our remarks on the question of credit-related insurance tie-ins, title VI, only and hope that our testimony will help in sorting out the many other issues these hearings encompass. IIAA and the other groups for which I'm speaking today have long been concerned with the continuing attempts of huge bank holding companies to enter the insurance business. The basis of that concern is the inherent and anticompetitive power of financial institutions to direct the sale of insurance by virtue of their control over credit transactions.

We testified before this committee on May 6 in support of H.R. 2255 and S. 207, identical bills that embody the same bank holding company insurance prohibition which is contained in title VI of S. 1720, the legislation currently before you.

In the interest of saving time, we will not repeat what we said just four months ago, except to say that the case for curtailing bank holding company insurance activities is even stronger today than it was during the two previous Congresses. You may recall that a prohibition similar to that in title VI of S. 1720 passed the House of Representatives last year by 333 to 25 and was unanimously reported out of this committee.

Our case may be simply stated. It remains a fact of life, supported by numerous academic and legislative studies, court findings and financial and consumer regulatory agency reports that the combination of credit and insurance, (1), unfairly constricts the consumer's ability to choose the best insurance terms and service, free from the influence of credit and (2), unfairly competes against other sellers in the insurance market, who have no powers to extend or withhold credit.

COURT FINDINGS

It is the old company store monopoly in a new guise. Several new elements have recently been injected into the financial institutions insurance debate. In September the U.S. Court of Appeals for the Eighth Circuit vacated an order of the Federal Reserve Board approving an insurance agency application of Mercantile Bancorporation, the largest banking institution in the State of Missouri. In its opinion, the court made clear that the presentations that

Mercantile made to the Board in support of its application did not begin to satisfy the requirements of the public benefit test contained in section 4(c)(8) of the Bank Holding Company Act.

The court also chastized the Board for using the fact that the Mercantile application was de novo rather than an acquisition of a going concern to create a presumption that the public benefits requirement of the Bank Holding Company Act were satisfied and ordered a hearing on the factual issues raised by HIAA. The court's opinion provides independent verification that the dangers that HIAA and other interested groups have been alleging for many years is real, not imaginery.

The court specifically entertained the possibility that bank holding company insurance activities could produce harmful anticompetitive effects as a result of coercive and voluntary tying. The court also recognized the possibility that bank holding company sales of insurance could create conflicts of interest and put the consumer in a position where he would pay more money for his insurance and receive less service in connection with it.

The action of the court also underscored the continuing, indeed, the apparently unending controversy that surrounds the bank holding company insurance issue. A controversy that only Congress has the power to end.

More recently the Federal Reserve Board took up the question of whether it should initiate a rulemaking proceeding to permit bank holding companies to sell renewal insurance, insurance that would be sold after the loan or other financial relationship was terminated. Such a regulation would represent a dramatic expansion of the current insurance authority of banks and bank holding companies.

You, Mr. Chairman, and several other members of this committee, provided the Board with letters expressing the view that an expansion of the Board's insurance regulation at this time would be inadvisable. Those letters and the fact of these hearings and similar hearings scheduled in the House, induced the Board to postpone further consideration of this renewal insurance issue for 6 months.

Nevertheless, the fact that the Board would even entertain the possibility of declaring renewal insurance to be closely related to banking showed the inclination of the Board with, of course, the constant and spirited urgings of large bank holding companies to strain the limits of bank holding company nonbanking authority. That inclination can only be restrained if Congress enacts an explicit statutory line that separates banking from insurance activities.

The Board's attempt to expand its insurance regulation is particularly ironic in the light of the September 18, 1981, report of the General Accounting Office dealing with the Board's oversight of bank holding company nonbank activities. That report should prove sober reading for any legislator who takes the time to become familiar with it. GAO figures indicate that bank holding companies that engage in nonbanking activities run the risk of becoming problems about 15 times greater than those that do not undertake nonbanking activities.

Treasury Secretary Regan, who just this past Monday advocated before your committee the holding company mode for banks and

thrifts to expand into newer financial services might profitably ponder the GAO report. The fact is, and virtually every study that has examined the question verifies this, bank holding companies simply do not perform nonbanking activities either efficiently or well.

The GAO report concludes that the Federal Reserve Board does not maintain adequate information on bank holding company non-banking activities by individual companies or for the industry as a whole. We are, therefore, gratified to see title VI included in S. 1720. Bank holding companies continue by a wide margin to be the dominant source of credit in our economy. As such, any attempt by Congress to separate the sale of insurance from credit extension must at least begin by amending the Bank Holding Company Act of 1956 in the way suggested by title VI.

At the same time, given some of the other things that S. 1720 would accomplish, title VI does not go far enough. The problem we see with S. 1720 arises out of the fact that banks and bank holding companies on the one hand and savings and loan holding companies and service corporations on the other, have different degrees of authority to engage in insurance activities. While Federal savings and loan associations are not permitted to engage in insurance directly, by regulation they are permitted to sell insurance through their service corporations. Savings and loan holding companies that own only one savings and loan association are permitted to engage in insurance activities of every kind. While multiple savings and loan holding companies may not underwrite insurance, they can pursue any kind of insurance agency activity.

Title I of S. 1720 would, among other things, expand the financial powers of Federal savings and loan associations to approximate those of national banks. As a consequence, in order to preserve the longstanding separation between the banking and the insurance business and in order to make S. 1720 internally consistent, it is necessary to adjust the insurance powers of Federal savings and loan holding companies and service corporations to reconcile those powers with the insurance authorities of banks and bank holding companies. Only in that way, will a level playing field for which bankers have been clamoring for many years, be maintained in the context of S. 1720.

At the appropriate time we will be prepared to present to the committee specific language that we believe will reconcile the insurance authority of thrift institutions affected by S. 1720 with the insurance limitations contained in title VI of the bill and the National Bank Act.

Chairman Volcker of the Federal Reserve Board recently told a gathering of bankers, "traditional separation between banking and commerce rests on concepts that concentration of economic power can be dangerous, that the potential for conflicts of interests in a service so vital as the extension of capital and credit should be minimized, and that there is a special public interest in the safety and soundness of our banks."

He concluded, therefore, that such separation is "fundamentally valid". That separation must be preserved, notwithstanding the temptation that might be presented by short term economic forces.

In the context of S. 1720, one of the ways that Congress can reinforce the principle of the separation between banking and commerce is to enact title VI with other appropriate amendments that would reconcile the insurance authority of banks and bank holding companies with the insurance authority of thrift institutions that would be invigorated by the new financial powers accorded by other provisions of the bill.

I would like to thank the committee for giving us the opportunity to express our views on S. 1720, and I am pleased to try to answer your question.

[Complete statement of Mr. Kremer and an additional statement ordered inserted in the record at this point follow:]

Remarks of
EDWARD J. KREMER

INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.

Mr. Chairman, my name is Edward J. Kremer. I am President of Hanna and Kremer Insurance Agency of Salisbury, Maryland, and a longstanding member of the Independent Insurance Agents of America.

IIAA is a national trade association representing over 126,000 licensed independent insurance agents and over 200,000 employees located in all 50 states and the District of Columbia.

The remarks I offer today are made on behalf of not only IIAA, but also of the National Association of Professional Insurance Agents (representing more than 38,000 independent property and casualty insurance agents in all 50 states, Puerto Rico, the Virgin Islands, and Canada), the National Association of Life Underwriters (a federation of 1,000 state and local associations, representing over 130,000 life and health insurance agents), and the National Association of Casualty and Surety Agents (the leading agency and brokerage firms in the country specializing in providing property and casualty insurance programs for business and industry and for many states and municipalities as well).

IIAA and the other groups for which I am speaking today have long been concerned with the continuing attempts of huge bank holding companies to enter the insurance business. The basis of that concern is the inherent and anti-competitive power of financial institutions to direct the sale of insurance by virtue of their control over credit transactions.

We testified before this Committee on May 6 in support of H.R. 2255 and S. 207, identical bills that embody the same bank holding company insurance prohibition which is contained in Title VI of S. 1720, the legislation currently before you. In the interest of saving time, we will not repeat what we said just four months ago, except to say that the case for curtailing bank holding company insurance activities is even stronger

today than it was during the two previous Congresses. You may recall that a prohibition similar to that in Title VI of S. 1720 passed the House of Representatives last year 333-25 and was unanimously reported out of this Committee.

That case may be simply stated: it remains a fact of life, supported by numerous academic and legislative studies, court findings, and financial and consumer regulatory agency reports that the combination of credit and insurance (1) unfairly constricts the consumer's ability to choose the best insurance terms, and service free from the influence of credit, and (2) unfairly competes against other sellers in the insurance market who have no powers to extend or withhold credit. It's the old company store monopoly in a new guise.

Several new elements have recently been injected into the financial institutions insurance debate. In September the United States Court of Appeals for the Eighth Circuit vacated an order of the Federal Reserve Board approving an insurance agency application of Mercantile Bancorporation, the largest banking institution in the state of Missouri. In its opinion, the Court made clear that the presentations that Mercantile made to the Board in support of its application did not begin to satisfy the requirements of the "public benefits" test contained in Section 4(c)(8) of the Bank Holding Company Act. The Court also chastized the Board for using the fact that the Mercantile application was de novo (rather than an acquisition of a going concern) to create a presumption that the public benefits requirements of the BHC Act were satisfied, and ordered a hearing on the factual issues raised by HIAA.

The Court's opinion provides independent verification that the dangers that HIAA and other interested groups have been alleging for many years is real, not imaginary. The Court specifically entertained the possibility that bank holding company insurance activities could produce harmful, anticompetitive effects as a result of coercive or voluntary tying.

The Court also recognized the possibilities that bank holding company sales of insurance could create conflicts of interest and put the consumer in a position where he would pay more money for his insurance and receive less service in connection with it. The action of the Court also underscores the continuing — indeed, the apparently unending — controversy that surrounds the bank holding company insurance issue — a controversy that only Congress has the power to end.

More recently, the Federal Reserve Board took up the question of whether it should initiate a rulemaking proceeding to permit bank holding companies to sell renewal insurance — insurance that would be sold after a loan or other financial relationship has terminated. Such a regulation would represent a dramatic expansion of the current insurance authority of banks and bank holding companies. You, Mr. Chairman, and several other members of this Committee, provided the Board with letters expressing the view that an expansion of the Board's insurance regulation at this time would be inadvisable. Those letters, and the fact of these hearings and similar hearings scheduled in the House, induced the Board to postpone further consideration of the renewal insurance issue for six months. Nevertheless, the fact that the Board would even entertain the possibility of declaring renewal insurance to be "closely related" to banking shows the inclination of the Board — with the constant and spirited urgings of large bank holding companies — to strain the limits of bank holding company non-banking authority. That inclination can be restrained only if Congress enacts an explicit statutory line that separates banking from insurance activities.

The Board's attempt to expand its insurance regulation is particularly ironic in light of the September 18, 1981, report of the General Accounting Office dealing with the Board's oversight of bank holding company nonbank activities. That report should prove sobering reading for any legislator who takes the time to become familiar with

it. For example, the GAO's figures indicate that bank holding companies that engage in non-banking activities run the risk of becoming problems about 15 times greater than those that do not undertake non-banking activities. Treasury Secretary Regan, who just this past Monday advocated before your committee the holding company mode for banks and thrifts to expand into newer financial services, might profitably ponder the GAO report.

For the fact is — and virtually every study that has examined the question verifies this — bank holding companies simply do not perform non-banking activities either efficiently or well. The GAO report concludes that "the Federal Reserve Board does not maintain adequate information on bank holding company non-banking activities — by individual company or for the industry as a whole."

We are therefore gratified to see Title VI included in S. 1720. Bank holding companies continue by a wide margin to be the dominant source of credit in our economy. As such, any attempt by Congress to separate the sale of insurance from credit extension must at least begin by amending the Bank Holding Company Act of 1956 in the way suggested by Title VI.

At the same time, given some of the other things S. 1720 would accomplish, Title VI does not go far enough.

The problem we see with S. 1720 arises out of the fact that banks and bank holding companies on the one hand, and savings and loan holding companies and service corporations on the other, have different degrees of authority to engage in insurance activities. While federal savings and loan associations are not permitted to engage in insurance directly, by regulation they are permitted to sell insurance through their service corporations. Savings and loan holding companies that own only one savings and loan association are permitted to engage in insurance activities of every kind. While multiple savings and loan holding companies may not underwrite insurance, they can pursue any kind of insurance agency activity.

Title I of S. 1720 would, among other things, expand the financial powers of federal savings and loan associations to approximate those of national banks. As a consequence, in order to preserve the longstanding separation between the banking and the insurance business, and in order to make S. 1720 internally consistent, it is necessary to adjust the insurance powers of federal savings and loan holding companies and service corporations to reconcile those powers with the insurance authority of banks and bank holding companies. Only in that way will the "level playing field" that bankers have been clamoring for many years be maintained in the context of S. 1720.

At the appropriate time, we will be prepared to present to the Committee specific language that we believe will reconcile the insurance authority of the thrift institutions affected by S. 1720 with the insurance limitations contained in Title VI of the bill and the National Bank Act.

Chairman Paul Volcker of the Federal Reserve Board recently told a gathering of bankers that the traditional separation between banking and commerce "rests on concepts that concentration of economic power can be dangerous, that the potential for conflicts of interest in a service so vital as the extension of capital and credit should be minimized, and that there is a special public interest in the safety and soundness of our banks." He concluded, therefore, that such separation is "fundamentally valid." That separation must be preserved — notwithstanding the temptation that might be presented by short-term economic forces. In the context of S. 1720, one of the ways that Congress can re-endorse the principle of the separation between banking and commerce is to enact Title VI with other appropriate amendments that would reconcile the insurance authority of banks and bank holding companies with the insurance authority of thrift institutions that would be invigorated by the new financial powers accorded by other provisions of the bill.

I want to thank the Committee for giving us this opportunity to express our views on S. 1720. If you have any questions, I would be pleased to try to answer them.



October 20, 1981

Honorable Jake Garn, Chairman
Senate Committee on
Banking, Housing, and Urban Affairs
United States Senate
5300 DSOB
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of Central States Health & Life Co. of Omaha I would like to respectfully request your consideration of a technical amendment to Title VI of S. 1720. I also request that this letter serve as our statement for your hearings beginning October 19, 1981 and that it be included in the hearing records.

Last year H.R. 2255 (the predecessor bill to S. 207) was amended to include the sale of involuntary unemployment coverage as a permissible insurance agency activity for bank holding companies. At the time it was introduced and adopted the amendment included additional tie-in language. This additional tie-in language is duplicative and unnecessary in light of existing statutory provisions. H.R. 2255 died in the 96th Congress, but when the provisions were reintroduced in the 97th Congress as S. 207 the excess language was inadvertently included. Title VI of S. 1720 incorporates the provisions of S. 207, as introduced, and hence also contains the unnecessary language.

During the Committee's oversight hearings this Spring Mr. Robert Reynolds, President of the Independent Insurance Agents of America, testified on S. 207 and stated that they had no objection to a technical amendment to strike the duplicative and unnecessary language (Hearings, Part I, page 342). We urge the Committee to strike this language. To demonstrate the fact that the language is unnecessary, attached hereto are copies of the present law, Section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972) and the subject portion of S. 1720 with the redundant language in brackets and underscored.

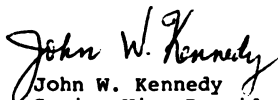
CENTRAL STATES HEALTH & LIFE CO. OF OMAHA
WESTERN AT 96TH BOX 34350
OMAHA, NEBRASKA 68134 PHONE: (402) 897-1111

It should be noted that in administering the Bank Holding Company Act, the Federal Reserve Board requires that any bank holding company proposing to engage in insurance underwriting or agency activities show that affirmative steps are taken to advise borrowers that the purchase of such insurance is not a condition of the extension of credit - but is purely at the option of the borrower.

The Federal Reserve Board's Regulation Y (12 C.F.R. Section 225.4(c)) requires that the "provision of any credit, property, or services involved (in any proposed nonbank activity) shall not be subject to any condition which, if imposed by a bank, would constitute an unlawful tie-in arrangement under Section 106 of the Bank Holding Company Act Amendments of 1970." In the concrete case of the Federal Reserve Board's consideration of whether a bank holding company affiliate would be permitted to offer this specific type of insurance, such assurances were required and made as a condition precedent to Federal Reserve Board approval.

As I noted earlier, when the bill was reintroduced this year as S. 207 the duplicative and unnecessary language was not removed. When S. 207, as introduced, was included as Title VI of S. 1720 the language remained. We respectfully urge you to strike the redundant language as shown in the attached copy of the bill. I appreciate your concern and effort in this matter.

Sincerely,



John W. Kennedy
Senior Vice President and
Associate General Counsel

Tie-In Provisions -- PRESENT LAW *

Definitions

12 USC 1971—As used in this section, the terms "bank," "bank holding company," "subsidiary," and "Board" have the meaning ascribed to such terms in section 2 of the Bank Holding Company Act of 1956. For purposes of this section only, the term "company," as used in section 2 of the Bank Holding Company Act of 1956, means any person, estate, trust, partnership, corporation, association, or similar organization, but does not include any corporation the majority of the shares of which are owned by the United States or by any State. The term "trust service" means any service customarily performed by a bank trust department.

Certain arrangements prohibited

12 USC 1972—A bank shall not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition or requirement—

- (1) that the customer shall obtain some additional credit, property, or service from such bank other than a loan, discount, deposit, or trust service;
- (2) that the customer shall obtain some additional credit, property, or service from a bank holding company of such bank, or from any other subsidiary of such bank holding company;
- (3) that the customer provide some additional credit, property, or service to such bank, other than those related to and usually provided in connection with a loan, discount, deposit, or trust service;
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- (5) that the customer shall not obtain some other credit, property, or service from a competitor of such bank, a bank holding company of such bank, or any subsidiary of such bank holding company, other than a condition or requirement that such bank shall reasonably impose in a credit transaction to assure the soundness of the credit.

The Board may by regulation or order permit such exceptions to the foregoing prohibition as it considers will not be contrary to the purposes of this section.

*Sec. 106, Bank Holding Company Act Amendment of 1970 (12 U.S.C. 1972).

Title 12—Banks and Banking

§ 225.4

(c) *Tie-ins, alterations, relocations, consolidations.* Except as otherwise provided in an order in a particular case, the following conditions shall apply with respect to every acquisition consummated or activity engaged in on the authority of section 4(c)(8) of the Act: (1) The provision of any credit, property or services involved shall not be subject to any condition which, if imposed by a bank, would constitute an unlawful tie-in arrangement under section 106 of the Bank Holding Company Act Amendments of 1970; (2) the activities involved shall not be altered in any significant respect from those considered by the Board in making the determination, nor provided at any location other than those described in the notice published with respect to such determination, except upon compliance with the procedures of paragraph (b)(1) of this section; and (3) no merger, or acquisition of assets other than in the ordinary course of business, to which the acquired company is a party shall be consummated without prior Board approval, if thereafter the bank holding company will continue to own, directly or indirectly, more than 5 percent of the voting shares of such company or its successor.

Regulation Y
12 C.F.R. Section 225.4(c)
Federal Reserve Board

97TH CONGRESS
1ST SESSION

S. 1720

To enhance the competitiveness of depository institutions, to expand the range of services provided by such institutions, to protect depositors and creditors of such institutions, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 7, 1981

Mr. GARN introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

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- 1 *Be it enacted by the Senate and House of Representa-*
- 2 *tives of the United States of America in Congress assembled,*
- 3 That this Act may be cited as the "Financial Institutions
- 4 Restructuring and Services Act of 1981".

1 failure to purchase shares from, obtain a loan from, or lend to
2 the Federal credit union.

3 “(c) Withdrawal or expulsion of a member pursuant to
4 either subsection (a) or (b) of this section shall not operate to
5 relieve him from liability to the Federal credit union.”.

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9 SEC. 601. Section 4(c)(8) of the Bank Holding Company
10 Act of 1956 (12 U.S.C. 1843(c)(8)) is amended by striking
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13 tion it is not closely related to banking or managing or con-
14 trolling banks for a bank holding company to provide insur-
15 ance as a principal, agent, or broker except (A) where the
16 insurance is limited to assuring repayment of the outstanding
17 balance due on a specific extension of credit by a bank hold-
18 ing company or its subsidiary in the event of the death, dis-
19 ability, or involuntary unemployment of the debtor~~and, in~~
20 the case of involuntary unemployment, where the coverage is
21 offered in connection with a bank credit card and the card-
22 holder is solicited to purchase the coverage after the credit
23 card has been issued by the creditor; (B) in the case of a
24 finance company which is a subsidiary of a bank holding com-
25 pany, where the insurance is also limited to assuring repay-
[—] represents language to be stricken.

The CHAIRMAN. Thank you very much. Senator Dixon?

Senator DIXON. Thank you, Mr. Chairman.

I wonder if I could direct several questions to Mr. Craigie. I notice you are a former treasurer of the Commonwealth of Virginia. I am a former State treasurer of Illinois. I do not know that I have had the pleasure to meet you.

NEW AND GREATER RISK

Mr. CRAIGIE. It is a pleasure to meet you, Mr. Dixon.

Senator DIXON. Of course, banks now have the power to underwrite GO bonds. Why do you think that revenue bonds represent a new and greater risk?

Mr. CRAIGIE. Actually, banks have the power to underwrite in a number of areas of revenue bonds right now. That took place in 1968, when they were given the additional powers to underwrite housing bonds and to underwrite higher education bonds and certain other rulings of the Comptroller of the Currency since that time. I would guess that one example that we might take right now of the potential problems in revenue bonds insofar as the risk would be the case of the Washington Public Power District out West, where there is a major problem in plants 4 and 5 and the ability to secure money even to mothball those plants. And the exposure that exists for the approximately \$2 billion that has already been raised.

It is of interest that commercial banks are able to underwrite and have been a manager of the plants 1, 2, and 3, the Bonneville projects, which just recently had the highest interest rate on revenue bond issue ever issued, 15 percent.

I think when you look at the types of revenue bonds that can be issued of many different varieties and nature, there is a considerable difference in the risk.

Senator DIXON. Don't you think that extending the authority banks would result in a more competitive bidding for the issue rather than negotiated issues?

Mr. CRAIGIE. I mentioned earlier the banks have been able to underwrite approximately 40 percent of the marketed revenue bonds right now and since 1968. The facts will show, and I Kaufman would be glad to respond to that question, say, in the housing area where banks have been significant in that area, shows there has been no savings, in fact, potentially a cost to the issuers, where banks have actually participated in the housing area.

There is no evidence presented thus far, really, that banks have any incentive to lower their costs or that they have moved competitive issues versus negotiated issues, when negotiated issues are available.

Senator DIXON. Your statement, Mr. Craigie, places great emphasis upon the potential combination of deposit taking by banks and securities activities by the same banks. Sears has a savings and loan which takes deposits. And it is buying a national full-service brokerage firm. American Express takes deposits through extensive international banking operations. It also has an enormous travel check operation and now owns one of the largest securities firms in this country. Shearson, Loeb, Rhodes, in turn, owns Boston Se

■ Deposit & Trust Co. Do you oppose the combination of services
■ represented in those cases by those companies?

■ Mr. CRAIGIE. I will pass that on to Mr. DeNunzio to answer. I
■ would answer to as far as commercial banks in my region.

■ Mr. DENUNZIO. There is no question that the concerns that you
bring out through the combination now of the Shearson and
■ American Express and others are of interest to this committee and
they are of major interest to our industry. There are some poten-
■ tial conflicts of interest in these areas. It is for this precise reason
■ that we think these conflicts of interest need to be examined in a
■ broader context than just S. 1720.

Senator Garn earlier asked one of the former panelists, is there a
■ concern that Shearson is able to own the Boston Safe Deposit in
■ Massachusetts. From Shearson's standpoint they are doing some-
■ thing perfectly legal. It is in the context of the laws of the State of
■ Massachusetts that allows them to do that; however, others could
■ reason that there is a loophole in the act that allows a State-
■ chartered bank to be acquired by an investment banking firm, and
■ it is, indeed, a fact that state-chartered banks in Massachusetts can
■ be acquired by investment banking firms. Now that is a concern to
■ a lot of investment banking firms and there are many people in
■ our industry who think that that loophole should not exist. But it
■ is there, and it is one of the reasons why we think that this whole
issue needs to be examined in a larger context.

Senator DIXON. Now it is certainly true that before passage of
the Glass-Steagall Act some bank security affiliates engaged in
activities which threatened the solvency of their institutions. There
have been a great many changes and improvements in the bank
regulatory system since that time. Do you nevertheless believe that
the same risks exist today if banks are given the authority to
underwrite municipal revenue bonds?

Mr. CRAIGIE. We do not have to go back too far to see that there
is the potential of those same risks involved. It is interesting that
the major bank problems, failures that have occurred within the
last 10 years: the Franklin National Bank, are primarily due to
investments in bonds; Bank of the Commonwealth, primarily due
to the investment in long-term municipal bonds. Other banks
today—will remain nameless but have had to resort in substantial
sums to the Federal Deposit Insurance Corporation and loans from
other banks, because of their exposure in the bonds markets. It
does not have to be just municipal bonds, it can be in Government
bonds.

I would say to you that the example of bank holding companies
and what they can do with nonbank assets—Chase REIT is one of
the best examples, where stockholders lost millions of dollars be-
cause they thought they were buying Chase and they were buying
REIT. The exposures do exist.

Senator DIXON. Dealer Bank claims that underwriting of revenue
bonds would result in savings for issuers. I understand that you
have witnesses who would take issue with that. I would like to
hear that.

The SIA argues that no appreciable savings would result. Profes-
sional economists disagree with this issue; but representatives of

it. For example, the GAO's figures indicate that bank holding companies that engage in non-banking activities run the risk of becoming problems about 15 times greater than those that do not undertake non-banking activities. Treasury Secretary Regan, who just this past Monday advocated before your committee the holding company mode for banks and thrifts to expand into newer financial services, might profitably ponder the GAO report.

For the fact is — and virtually every study that has examined the question verifies this — bank holding companies simply do not perform non-banking activities either efficiently or well. The GAO report concludes that "the Federal Reserve Board does not maintain adequate information on bank holding company non-banking activities — by individual company or for the industry as a whole."

We are therefore gratified to see Title VI included in S. 1720. Bank holding companies continue by a wide margin to be the dominant source of credit in our economy. As such, any attempt by Congress to separate the sale of insurance from credit extension must at least begin by amending the Bank Holding Company Act of 1956 in the way suggested by Title VI.

At the same time, given some of the other things S. 1720 would accomplish, Title VI does not go far enough.

The problem we see with S. 1720 arises out of the fact that banks and bank holding companies on the one hand, and savings and loan holding companies and service corporations on the other, have different degrees of authority to engage in insurance activities. While federal savings and loan associations are not permitted to engage in insurance directly, by regulation they are permitted to sell insurance through their service corporations. Savings and loan holding companies that own only one savings and loan association are permitted to engage in insurance activities of every kind. While multiple savings and loan holding companies may not underwrite insurance, they can pursue any kind of insurance agency activity.

Title I of S. 1720 would, among other things, expand the financial powers of federal savings and loan associations to approximate those of national banks. As a consequence, in order to preserve the longstanding separation between the banking and the insurance business, and in order to make S. 1720 internally consistent, it is necessary to adjust the insurance powers of federal savings and loan holding companies and service corporations to reconcile those powers with the insurance authority of banks and bank holding companies. Only in that way will the "level playing field" that bankers have been clamoring for many years be maintained in the context of S. 1720.

At the appropriate time, we will be prepared to present to the Committee specific language that we believe will reconcile the insurance authority of the thrift institutions affected by S. 1720 with the insurance limitations contained in Title VI of the bill and the National Bank Act.

Chairman Paul Volcker of the Federal Reserve Board recently told a gathering of bankers that the traditional separation between banking and commerce "rests on concepts that concentration of economic power can be dangerous, that the potential for conflicts of interest in a service so vital as the extension of capital and credit should be minimized, and that there is a special public interest in the safety and soundness of our banks." He concluded, therefore, that such separation is "fundamentally valid." That separation must be preserved — notwithstanding the temptation that might be presented by short-term economic forces. In the context of S. 1720, one of the ways that Congress can re-endorse the principle of the separation between banking and commerce is to enact Title VI with other appropriate amendments that would reconcile the insurance authority of banks and bank holding companies with the insurance authority of thrift institutions that would be invigorated by the new financial powers accorded by other provisions of the bill.

I want to thank the Committee for giving us this opportunity to express our views on S. 1720. If you have any questions, I would be pleased to try to answer them.



October 20, 1981

Honorable Jake Garn, Chairman
Senate Committee on
Banking, Housing, and Urban Affairs
United States Senate
5300 DSOB
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of Central States Health & Life Co. of Omaha I would like to respectfully request your consideration of a technical amendment to Title VI of S. 1720. I also request that this letter serve as our statement for your hearings beginning October 19, 1981 and that it be included in the hearing records.

Last year H.R. 2255 (the predecessor bill to S. 207) was amended to include the sale of involuntary unemployment coverage as a permissible insurance agency activity for bank holding companies. At the time it was introduced and adopted the amendment included additional tie-in language. This additional tie-in language is duplicative and unnecessary in light of existing statutory provisions. H.R. 2255 died in the 96th Congress, but when the provisions were reintroduced in the 97th Congress as S. 207 the excess language was inadvertently included. Title VI of S. 1720 incorporates the provisions of S. 207, as introduced, and hence also contains the unnecessary language.

During the Committee's oversight hearings this Spring Mr. Robert Reynolds, President of the Independent Insurance Agents of America, testified on S. 207 and stated that they had no objection to a technical amendment to strike the duplicative and unnecessary language (Hearings, Part I, page 342). We urge the Committee to strike this language. To demonstrate the fact that the language is unnecessary, attached hereto are copies of the present law, Section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972) and the subject portion of S. 1720 with the redundant language in brackets and underscored.

CENTRAL STATES HEALTH & LIFE CO. OF OMAHA
WESTERN AT 86TH BOX 34350
OMAHA, NEBRASKA 68134 PHONE: (402) 387-1111

It should be noted that in administering the Bank Holding Company Act, the Federal Reserve Board requires that any bank holding company proposing to engage in insurance underwriting or agency activities show that affirmative steps are taken to advise borrowers that the purchase of such insurance is not a condition of the extension of credit - but is purely at the option of the borrower.

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(c) *Tie-ins, alterations, relocations, consolidations.* Except as otherwise provided in an order in a particular case, the following conditions shall apply with respect to every acquisition consummated or activity engaged in on the authority of section 4(c)(8) of the Act: (1) The provision of any credit, property or services involved shall not be subject to any condition which, if imposed by a bank, would constitute an unlawful tie-in arrangement under section 106 of the Bank Holding Company Act Amendments of 1970; (2) the activities involved shall not be altered in any significant respect from those considered by the Board in making the determination, nor provided at any location other than those described in the notice published with respect to such determination, except upon compliance with the procedures of paragraph (b)(1) of this section; and (3) no merger, or acquisition of assets other than in the ordinary course of business, to which the acquired company is a party shall be consummated without prior Board approval, if thereafter the bank holding company will continue to own, directly or indirectly, more than 5 percent of the voting shares of such company or its successor.

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Mr. CRAIGIE. We do not have to go back too far to see that there is the potential of those same risks involved. It is interesting that the major bank problems, failures that have occurred within the last 10 years: the Franklin National Bank, are primarily due to investments in bonds; Bank of the Commonwealth, primarily due to the investment in long-term municipal bonds. Other banks today—will remain nameless but have had to resort to substantial sums to the Federal Deposit Insurance Corporation and loans from other banks, because of their exposure in the bonds markets. It does not have to be just municipal bonds, it can be in Government bonds.

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Senator DIXON. Dealer Bank claims that underwriting of revenue bonds would result in savings for issuers. I understand that you have witnesses who would take issue with that. I would like to hear that.

The SIA argues that no appreciable savings would result. Professional economists disagree with this issue; but representatives of

municipal issuers groups are united in believing that interest savings would result.

Aren't these issuers, after all, the best judges of whether added bank participation in the markets would be beneficial?

Mr. CRAIGIE. Being a former State treasurer myself, and having worked for many, many years with local governments as an issuer, if there was any way that I thought that I could get one basis point—much less 10 basis points—I would certainly want to do so.

I think the Securities and Exchange Commission, in its study that was published in October 1979, has some pretty interesting figures. This covered 997 securities firms and their revenues in 1977.

Out of those figures—talking about small issuers, now, municipal revenue bonds—smaller broker dealers underwrote over 57 percent of bond issues with less than \$5 million in principal amount, and over 63 percent of less than \$1 million in principal amount.

They came to the conclusion that there would be a significant loss in broker-dealers, and therefore in the marketplace, in serving a number of municipalities overall.

My experts can testify on the other figures, and I am delighted to have them do so at this time. But I would also say to you—and this is in looking at this issue, in the full context of Glass-Steagall—the SBA and the SEC, in their two studies of the role of the broker-regional dealer in the capital formation process—which is a follow-up to the 1979 report—a report in March 1980 and August 1981. They reveal some very interesting figures with respect to the importance of broker-dealers—regional broker-dealers—in the capital formation process. It covers a 9-year period, from 1972 to 1980.

Regional broker-dealers managed 79 percent of all initial public offerings, in raising \$2.8 billion. This represented 56 percent of the \$5 billion raised by over 1,000 firms through managed public offerings. Two regional broker-dealers managed 92 percent of all offerings of less than \$10 million in annual revenues. Three broker-dealers also managed 82 percent of their offerings of natural resources and high technology firms.

When you really consider the impact that this could have on our total capital formation process, I would think that we would want to think very hard and very carefully about it.

I would be delighted to have Dr. Kaufman talk on the interest cost savings.

INTEREST COST SAVINGS

Dr. KAUFMAN. We were hired by the Securities Industry Association in 1978, to review a study done by Prof. Philip Cagan for the Dealer Bank Association, which found very large savings—amounting to, I believe, over \$400 million in present value—in 1977 alone.

We subjected the Cagan test to careful scrutiny, and we found three major flaws in the analysis:

One, there were serious errors in the classification of bank eligibility. Approximately one-quarter of the bonds in Cagan's sample were incorrectly classified.

Two, he used an incompletely specified economic model that statistically confused bank eligibility with other characteristics of the bonds that were not specified in the model.

Three, he assumed—contrary to the evidence, Senator Dixon—that bank eligibility would cause State and local governments to sell more by competitive bid than by negotiation.

We corrected each of these errors. The commercial bank eligibility status of each bond in Cagan's own sample was determined by the respected independent bond counsel firm of Wood-Dawson. We insisted on that. We did not want to have anybody who was not a bond counsel classify the bank eligibility for this study.

Cagan's basic econometric model was extended, to control for all possible characteristics of municipal revenue bonds.

Most importantly, we included the purpose for which the bond was issued—or example: housing, hospital, parking facilities—a characteristic that the market uses to determine the credit quality of the issue, in addition to the letter credit rating that is provided by the major rating agencies.

When these corrections are made, Cagan's own sample of municipal revenue bonds sold between 1973 and 1976 shows no statistically significant interest cost differences between bank-eligible and bank-ineligible bonds, either sold by negotiation or by competitive bid. Moreover, these findings are even more conclusive when the analysis is updated to include revenue bonds sold in 1979.

There is a possibility that the result we found for 1973-76, even though we used Cagan's own sample, can be unique to that period. We were asked, after we completed the first study, to undertake a second study and see if the results held up or were different for 1979.

When we applied the data for 1979 to Cagan's old, abbreviated model—not the expanded model that we used—we found that for competitively sold bonds, bank-eligible bonds had a higher interest rate than bank-ineligible bonds, because there were fewer bidders than for comparable bank-eligible bonds.

Now, I find that result implausible. I do not believe that bank eligibility would increase interest rates.

When we expanded the model—as we had done earlier for 1973-76—when we expanded it to look at the 1979 data, we found exactly the same results that we had found for the earlier periods. There was no statistical significant difference in the interest costs on bank-eligible and bank-ineligible bonds.

Consequently, we conclude that bank eligibility would have no effect, one way or the other, on the interest costs on municipal revenue bonds.

Senator DIXON. One would have to conclude, as a layman, from your study that what you are testifying to here is that enlarging competition makes no difference in price.

Dr. KAUFMAN. No, sir. I do not believe that that is the case.

Senator DIXON. It happens to be, though, what you draw as a conclusion—as a lay person—from the suggested result of your study, I think.

Dr. KAUFMAN. Let me answer that as follows.

There are two possibilities where you could have reduced interest rates:

One, there is not sufficient competition among underwriters now. That is a conclusion that Professor Cagan did not make in his own

study. He found that only \$7 million of the \$400 million came from a reduced underwriter profit.

The other possibility is that the greater number of underwriters are going to sell the bonds at a higher price, not a lower price, because interest rates and bond prices, as you know, are inversely related. So, if you reduce interest rates you increase the price of the bond.

Now, if you suddenly have a new grocery store coming into your area, you would expect that the prices of the products at the grocery store are going to be lowered. It is very difficult to imagine that if you have an increased number of sellers of bonds selling to the investors, that they would be selling them at a higher price, not a lower price.

As a result, the first person to have looked at this was Prof. Rubin Kestler at the University of Chicago, in 1971. He concluded that if competition did not raise the price, then why else care. He had a very fertile imagination, and concluded that what would happen is that the underwriters are going to find new customers, new investors, who would be willing to buy these bonds at a higher price.

Now, you have to assume that there are major investors who have never heard of Merrill Lynch and Goldman Sachs, and some of these very pussycat and nonaggressive firms that are on this table, so that, if you do not assume that there are significant numbers of investors who had never heard of these firms, who do not buy equities—after all, if they buy equities, they could only deal at the moment with the investment banking community, not with the commercial banking community—then it makes logic and good economic theory that increased competition would lower the price of bonds, not raise them.

But one has to remember that investors are middlemen. They buy the bonds from the State and local issuers, and they sell them to investors. If you believe there is competition on both sides, not just one side, competition on the side where they buy the bonds from the issuer, and then competition on the selling side, the two sides of the market, then there should be no net effect.

The bottom line is that there is any contraction of economic activity.

Now, I think you have been extremely helpful. Laughter.

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There are a few points, I believe, that need to be made, to put the previous questions and answers in context.

There was an allegation made that somehow bank participation in the underwriting of the Washington Public Power System bonds helped raise the interest rate to a 15-percent level. It should be understood by everybody that the manager of that syndicate was Merrill Lynch. That was a \$750 million issue, the largest issue ever. Every broker-dealer in the country was involved in it, and nearly every bank dealer was involved in it.

The people who were issuing the bonds were happy to get the money at any price, and they thought it was very, very fair under the circumstances of the credit problems that had occurred there. That was really the reason for the 15 percent, combined with a very difficult time in the market; and it had nothing to do with banks being able to underwrite that issue.

There were also statements made that somehow investment activities of banks have gotten them into trouble. And if I heard it right, it sounded as though it was risky for banks to invest in Government bonds—U.S. Government bonds. I do not really think that that was what was meant—at least I hope that was not what was meant.

Of course, those banks that got themselves into difficulty really were operating on the investment side, not on the trading side. What we are talking about here is owning a revenue bond for 10 minutes. We already have the authority, as a bank, to own a revenue bond for 10 months or 10 years. I think in many ways, holding it for 10 minutes is less risky than the basic lending and investment activity that we are already involved in.

BANKS NEED SMALL DEALERS

A point about small dealers. Suddenly, the introduction of bank competition is going to be terrible for small dealers. We are all concerned about small dealers. There are plenty of small shoe stores in this country that operate very well in the face of Sears selling shoes and shoes being sold mail order; and still, the small store operates very well.

Don't you think that the small dealer presently is operating in the face of Merrill Lynch competition and Goldman Sachs competition, and offices all over the country—Bache—or should I say Sears and Prudential? I'm not sure which name I'm supposed to use. And yet, the small dealer continues to survive today, and to survive very well.

I might also add that the banks need the small dealers more than the large securities firms, because banks typically operate out of one office; whereas Merrill Lynch and Goldman Sachs and Dean Witter, and so on, operate out of offices all over the country. We need the local distribution of the small dealers. We need the small dealers' contact with the local issuers. We need to work together with them.

We are more helpful to the small dealer than Merrill Lynch or Dean Witter is. The last point I want to make is that the securities industry seems to be more helpful to the small dealer than Merrill Lynch or Dean Witter is. The last point I want to make is that the securities industry seems to be more helpful to the small dealer than Merrill Lynch or Dean Witter is.

to talk about the most, because they have done the most work in trying to re-do his statistics.

The point is not a subtle statistical analysis; the point is a broad one. Virtually every economic study that has been done—and there have been many done by the Federal Reserve, by Prof. Richard West, and by many others, over a lot of years—every study that has been done shows that there are savings.

They vary in amounts, but it shows that there are savings, and it should not be surprising that economists really do agree with commonsense.

I would like to do something that I am not sure is permitted under the rules. I would like to quote an economist that we have not paid for, that we have not hired.

Last week, Herbert Stein, the distinguished former Chairman of the President's Council of Economic Advisors and professor at the University of Virginia, talking about a different economic issue, said that we have difficulty, as laymen, in ferreting out economic questions because the media serves to help bad talk drive out the good.

He said you could have an economic issue on which on one side—15,000 economists, and every living president of the American Economic Association—agree, and on the other side, 6 people, including 2 economists, take the contrary view and the media comes in and says, well, economists are in disagreement on this issue, and let's get a representative of each side, and then we will report the opposing side views? And somehow, in the attempt to create a fairness, the real balance is lost to the laymen. I think that is what has really happened here.

The CHAIRMAN. Thank you, Mr. Schneider.

I am convinced of one thing after this last interchange: That I do not understand all I know about this subject.

We do have a vote going. We will have to submit some questions to you for your response in writing.

Not only do we have another panel, but Senator Dixon and I will both have to go.

Let me make one comment about this issue. Without any facts, without any statistics to back me up, without any economists:

I firmly believe it would save the cities of this country money—and I say that from the standpoint of a former mayor, because I had a great deal to do with the competitive bidding process, not only in construction projects but tax anticipation notes and a lot of financial instruments.

I have a gut feeling that the professors can discount at will, but professors did not run cities; mayors did, and do. Some things do not fit all of the rules of the econometric models, and so on. I cannot imagine trying to negotiate tax anticipation notes and other financial instruments. There is no doubt in my mind that there was intense bidding—just our tax anticipation notes. I cannot believe that the same thing would not be true in municipal revenue bonds, where we would see a much greater competitive situation if people had to bid on them.

I really want to go back over what you said, because it was very impressive. But I'm going to have to read it and underline it, to go through it.

I do apologize for the vote occurring.

I very much appreciate all of your testimony and your willingness to be here today. And we will undoubtedly be submitting some questions to you for your response.

Thank you very much. If the next panel would come forward, then we will vote, the committee will be in recess for about 15 minutes.

[Recess.]

The CHAIRMAN. Back on the record.

I apologize, gentlemen, for the interruption, but we cannot control the lights and the bells. We are happy to have you with us.

STATEMENTS OF WILLIAM H. HUDNUT III, PRESIDENT, NATIONAL LEAGUE OF CITIES; RICHARD CONDER, PRESIDENT, NATIONAL ASSOCIATION OF COUNTIES; AND WILLIAM REYNOLDS, PRESIDENT, MUNICIPAL FINANCE OFFICERS ASSOCIATION

The CHAIRMAN. Mayor Hudnut, would you like to proceed?

Mr. HUDNUT. Thank you very much, Mr. Chairman.

I am Bill Hudnut, mayor of Indianapolis and president of the National League of Cities, which represents, either directly or indirectly through membership in State municipal leagues and our organization, some 15,000 cities of all sizes and geographic locations.

I do not have to tell you that. You used to be one of us.

The CHAIRMAN. They have not even changed the speech. I thought maybe we would get to 16,000 or something. I used to make the same pitch myself. [Laughter.]

Mr. HUDNUT. I might say before I start, that I am sorry my distinguished predecessor as mayor of Indianapolis, Richard Lugar, cannot be with us. He is one of the most esteemed citizens that the Hoosier State has ever produced.

The CHAIRMAN. I would interrupt and say Dick and I served on the National League of Cities board of directors together. I was fortunate enough to be able to participate in the coup in Los Angeles, when Dick was first or second vice president, and we beat John Lindsay on the floor of the convention.

Mr. HUDNUT. He was in the air, on his way back to New York, thinking he had won.

The CHAIRMAN. So Dick returned the favor in 1974. The convention was in Indianapolis. I became second vice president of NLC, although I got a much better deal than you, because I never did serve as president. I was due to become president 3 weeks after I got elected to the Senate. They gave me a better deal. They made me honorary president of the National League of Cities for 1975, and gave me a beautiful plaque for how much they missed my leadership; and I didn't have to do anything. It was better than they ever gave a president who actually served. I got the best of all worlds.

Mr. HUDNUT. Well, Senator, I have been told that you hold the record for having been the president of NLC for the shortest length of time of anybody in the history of the organization. I am glad that you have had the privilege to serve the people of your State more than one day over here.

The CHAIRMAN. Thank you.

Mr. HUDNUT. We are very honored that we have been invited to make a presentation on the legislation that you and Senator Lugar have introduced, S. 1720 and S. 1686. We are here to state our support for this legislation, to express the hope that it will be enacted into law, and to express the further hope that the other body—where I was privileged to serve at one time—will also act positively on the ideas contained in your bills.

We are very grateful for the chance to express what has been our position for more than 15 years, and is part of our formal municipal policy, with regard to title III of S. 1720. We don't feel that we have the competence to speak on the entire bill, which is a very complex piece of legislation.

With reference to title III, we strongly favor it. It would permit commercial banks to underwrite and deal in investment quality municipal revenue bonds. We are heartily in favor of that.

As we all know, since 1933 there has been a great increase in the utilization of municipal revenue bonds. At that time, when the Glass-Steagall Act was enacted, banks were expressly permitted to underwrite and deal in general obligation bonds. The use of revenue bonds was virtually nonexistent. It is different now, as you know because of your familiarity with the cities.

REVENUE BONDS

State and local governments and other public authorities use revenue bonds now to finance numerous essential public projects—roads, bridges, public transit, airports, water and sewer projects, public power systems, and all types of public buildings. I believe we are headed toward a national crisis when it comes to maintaining the infrastructure of this country, which is deteriorating, because cities are organisms just like people are, and we get older.

This legislation comes at a time when the Federal Government is essentially cutting back funding for such projects, and when local voters are growing increasingly resistant to add-ons to their general property taxes, another reason why we are in favor of this legislation.

It makes a great deal of sense to us that there be the greatest potential number of buyers and sellers of these revenue bonds, to keep costs down for issuers and their taxpayers, and to assure that capital is available to handle the demands on the market.

As has been obvious this morning, there has been conflicting testimony presented to you about the extent of the savings that will be realized if commercial banks are allowed to underwrite revenue bonds. Some of my friends tell me there will be savings; others tell me there won't be. I am for my friends, Mr. Chairman.

Our organization, the National League of Cities, is convinced that savings will result, for the commonsense reason that the laws of economics, it seems to us, will govern these transactions and generally lower the costs through more competition.

Along the same line, we have heard another curious argument against this legislation. It should not be passed, it is said, unless it can be proven beyond doubt that savings will result. We would offer you this, sir: We think the burden of proof should rightly fall

on those who seek to limit competition, rather than on those who wish to expand it.

We also feel that if S. 1686, which is being introduced by your distinguished colleague and my distinguished predecessor as mayor of Indianapolis, Richard Lugar, were to be incorporated into S. 1720, that it would add strength to that bill. We certainly hope that that will be considered by you and by the members of your committee.

S. 1686 will certainly aid State and local governments in improving their cash management practices. We appreciate Senator Lugar's initiative and hope that it will be folded into S. 1720.

Two changes in banking practices would result from this bill, both of which we think are significant:

First, State and local general purpose governments would be permitted to establish NOW accounts, checking accounts with interest, at financial institutions.

And second, it would allow State and local governments to deposit idle funds in financial institutions on demand, and earn interest at rates slightly below the Federal funds rate. We are in favor of that.

We think it is important to clarify the wording in the Deregulation and Monetary Control Act of 1980. As we all know, there was some ambiguity about what was meant by such phrases as "not operated for profit." That is at the heart of the dispute. General purpose State and local governments are not for profit; but can they establish NOW accounts?

To clear up the dispute, we would hope that this bill would be enacted into law to make it very clear, unequivocally, in the statute—which we think would be in keeping with the spirit of the 1980 act—that State and local general purpose governments ought to be permitted to use NOW accounts because they are nonprofit entities.

S. 1686, which is neutral with respect to which governments can have access to NOW accounts, and which financial institutions can offer them, would help clear the air.

The second feature of S. 1686 has no previous controversy associated with it. It would permit State and local governments to do what the Federal Government can already do: deposit funds in financial institutions on demand at interest rates slightly below the average Federal funds rate. It would remove the reserve requirements on State and local government deposits, but require that such deposits be secured by U.S. Government, government agency, or municipal securities, and permit higher interest rates to be paid on the deposits.

It would treat State and local funds the same as Federal funds. We think that is not only appropriate but in the interest of justice and equity.

Let me say one more word. We represent, as we mentioned, cities of all sizes. We represent a lot of small cities throughout the country, Mr. Chairman, and as we all are aware, small cities do not usually have the staff to carry on sophisticated cash management programs. Sometimes they lack sufficient fund balances to make the high-interest investments that a large city can make routinely.

Whenever possible, state and local officials will seek to do public works projects only when a direct fee or service charge from a project can be identified as a revenue source. This means using revenue bonds to finance the projects. However, the costs of construction projects have skyrocketed due to inflation and interest rates on bonds are through the roof. It only makes sense that there be the greatest potential number of buyers and sellers of these revenue bonds as possible to keep costs down for issuers and their taxpayers and to assure that capital is available to handle the demands in the market.

You no doubt have heard conflicting arguments about how much money State and local governments can expect to save if commercial banks are allowed to underwrite revenue bonds. We are uncertain of the amount, but we are convinced that savings will result because common sense tells us that the laws of economics will govern and lower costs will result from more competition.

Let me remind the Committee that in the bond business small fractions translate into big dollars. A difference of only two-tenths of one percent of interest on a \$25 million, 25-year bond computes to a \$650,000 difference over the life of the issue, for example, a sum not insignificant to local taxpayers.

Along this same line, we have heard another curious argument that this legislation should not be passed unless it can be proven beyond doubt that savings will result. To that fallacious reasoning, our response is that the burden of proof should rightfully fall on those who seek to limit competition rather than on those who wish to expand it.

I want to point out, too, that the current number of competitors for our revenue bond business is not staying constant but is actually declining. Since 1970, over 350 securities firms have disappeared, usually because of mergers. It seems to us that the shrinking number of firms in the industry cannot be in the best interest of the issuers who are seeking the lowest possible cost of issuance. Entry of commercial banks into the market would open up the pool of competitors for our business.

We are aware that on two previous occasions the Senate has passed legislation similar to Title III of S. 1720. It is in the House where many attempts over the last decade to get this legislation enacted have been stymied. However, another bill has been introduced this year and as of October 15, 208 Members have added their names as co-sponsors. Perhaps, with this broad support, your help now in moving the issue along, plus the legislation's obvious good sense in its favor, we can at last win passage.

Turning now to S. 1686, I want to first commend my own Senator and predecessor as Mayor of Indianapolis, Dick Lugar, for sponsoring this bill. It will certainly aid State and local governments in improving their cash management practices, and I appreciate his making this initiative.

S. 1686 would make two changes in banking practices: First, State and local general purpose governments would be permitted to establish NOW accounts, or checking accounts with interest, in financial institutions. Second, it would allow State and local governments to deposit idle funds in financial institutions on demand and earn interest at rates slightly below the Federal funds rate.

You will recall that when the Depository Institutions Deregulation and Monetary Control Act of 1980 was passed, it permitted certain organizations, as well as individuals, to establish NOW accounts. The law states specifically that NOW accounts are available to "an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit." The meaning of this language has been the subject of some debate ever since the law was passed.

At the heart of the dispute is the question of whether general purpose State and local governments can establish NOW accounts. A literal reading of the language seems to indicate that they cannot. On the other hand, it has been argued that school districts or libraries, if their funds are kept separate from general purpose funds, could establish NOW accounts.

The debate boiled over recently when the Federal Home Loan Bank Board issued a regulation permitting savings and loans to offer NOW accounts to all State and local governments at the same time the Federal Reserve Board proposed that banks could not offer such accounts. The FHLBB regulation was quickly challenged by the American Bankers Association which was successful in winning a U.S. District Court permanent injunction prohibiting State and local government participation in NOW accounts.

NLC's position in all this has been straight-forward. We think State and local general purpose governments ought to be permitted to use NOW accounts since they are non-profit entities, which is in the spirit of the 1980 Act. Moreover, we think it would be silly to permit some local governments to have them and not

others and disruptive to allow some financial institutions to offer them and not others.

S. 1686 would clear the air. It is neutral with respect to what governments can have access to NOW accounts and which financial institutions can offer them. It improves the 1980 Act by making an expressed provision for NOW accounts for State and local governments.

The second feature of S. 1686 has no previous controversy associated with it. It would permit state and local governments to do what the Federal Government can already do—deposit funds in financial institutions on demand at interest rates slightly below the average Federal Funds rate. State and local government demand deposits currently are subject to reserve requirements and cannot earn a rate of interest higher than the rate paid on NOW accounts.

S. 1686 would remove the reserve requirements on state and local government deposits but require that such deposits be secured by U.S. Government, Government Agency, or municipal securities. In addition, it would permit the higher interest rates on the deposits. The bill would treat state and local government funds the same way federal funds are handled.

While these two changes would be beneficial to all governments, I want to emphasize that they would be particularly advantageous to small cities. Small cities do not usually have the staff to carry on sophisticated cash management programs. They also sometimes lack sufficient fund balances to make high-interest investments that large cities can make routinely. Both measures contained in S. 1686 are easy to use and give small cities better tools to assure that temporarily idle funds are invested at the maximum return possible.

Mr. Chairman, it is not very often that we can appear before this Committee to make three requests for legislation that will not cost the Federal Government any money. We have done so today in the interest of saving local governments money. These are "good government" proposals that we hope you will act on soon.

The CHAIRMAN. Thank you.

Mr. Conder?

Mr. CONDER. Thank you very much for giving me this opportunity to appear before you today, to testify in support of your bill, Senate bill 1720.

As you have stated, my name is Richard Conder. I am chairman of the board of commissioners in Richmond County, N.C. I am also president of the National Association of Counties, and I am appearing here on NACo's behalf.

NACo, as you probably know, represents approximately 2,200 counties in America today, which represents in excess of 85 percent of the total population of this country.

Mr. Chairman, at the outset of my statement, I want to point out that NACo first reviewed this issue and adopted a policy of support in May of 1977. Since that time, our policy has been reaffirmed annually and reflects a consistent position that allowing commercial banks to underwrite public purpose municipal revenue bonds would enable State and local governments to realize savings by permitting increased competition in the municipal bond market.

The committee is well aware of the historical background of this issue. I will not burden you with restating that history other than to emphasize that the trend toward local government use of revenue bonds, rather than general obligation bonds, for vital public projects has been dramatic and steadily increasing since 1965. In 1980, revenue bonds totaled \$35 billion and constituted more than 70 percent of all long-term bonds sold by State and local governments.

The reasons for more intensive use of this debt instrument are rooted in the adverse fiscal conditions that have confronted local government in recent years:

LOCAL GOVERNMENT RESTRICTIONS

Twenty-six States have established tax limitations on their local governments;

Many others have limited increases in local governments;

Double-digit inflation has eroded the buying power of the local government service dollar; and

Voters frequently have rejected referenda for tax-supported capital expenditures by local governments.

In addition, numerous States have imposed ceilings on the amount of general obligation debt localities can incur. In my own State of North Carolina, for example, State law provides that total long-term general obligation indebtedness may not exceed 8 percent of assessed property valuation in counties.

Local governments faced with restrictions such as these have been forced to find ways of satisfying increased citizen demands for services with decreasing sources of revenue. Many of them have turned to revenue bonds as a financing tool for essential public purpose projects. This trend has been encouraged by some agencies within the Federal Government, particularly the Environmental Protection Agency, which has urged local governments to utilize revenue bonds in financing the construction of water and sewer treatment plants.

Counties in my State and the United States generally that have increased their issuance of revenue bonds have done so in an atmosphere of intense public scrutiny, one that demands fiscal prudence. Consequently, our counties have sought to issue these bonds at the least possible cost to local taxpayers.

The current prohibition of commercial bank underwriting of most types of revenue bonds has undermined the ability of our governments to save the public dollar because it has limited competition in the municipal bond market. It has ignored the fundamental and generally recognized economic principle that increased competition lowers costs in a market economy.

It is only common sense that dictates that the more supermarkets you see in a given area, the lower the cost of food is going to be.

Extensive testimony has been offered in earlier hearings on this issue, concerning the potential savings that would accrue to local government issuers through commercial bank underwriting of municipal revenue bonds. The conflicting conclusions reached by studies about the amount of these savings have been presented in detail.

I will not belabor these statistics or attempt to make a judgment concerning the accuracy with which savings have been estimated in these studies. Rather, I would emphasize that all the studies have indicated that some savings would be realized by local government issuers of revenue bonds, and no study has maintained that local governments would incur greater costs as a result of commercial bank entry into the revenue bond market.

Prof. William L. Silber of New York University reviewed and analyzed 12 of these studies in 1979. He concluded that the participation of commercial banks in underwriting and trading municipal revenue bonds would have resulted in savings to State and local governments of somewhere between \$150 and \$300 million in 1977.

municipal issuers groups are united in believing that interest savings would result.

Aren't these issuers, after all, the best judges of whether added bank participation in the markets would be beneficial?

Mr. CRAIGIE. Being a former State treasurer myself, and having worked for many, many years with local governments as an issuer, if there was any way that I thought that I could get one basis point—much less 10 basis points—I would certainly want to do so.

I think the Securities and Exchange Commission, in its study that was published in October 1979, has some pretty interesting figures. This covered 997 securities firms and their revenues in 1977.

Out of those figures—talking about small issuers, now, municipal revenue bonds—smaller broker dealers underwrote over 57 percent of bond issues with less than \$5 million in principal amount, and over 63 percent of less than \$1 million in principal amount.

They came to the conclusion that there would be a significant loss in broker-dealers, and therefore in the marketplace, in serving a number of municipalities overall.

My experts can testify on the other figures, and I am delighted to have them do so at this time. But I would also say to you—and this is in looking at this issue, in the full context of Glass-Steagall—the SBA and the SEC, in their two studies of the role of the broker-regional dealer in the capital formation process—which is a follow-up to the 1979 report—a report in March 1980 and August 1981. They reveal some very interesting figures with respect to the importance of broker-dealers—regional broker-dealers—in the capital formation process. It covers a 9-year period, from 1972 to 1980.

Regional broker-dealers managed 79 percent of all initial public offerings, in raising \$2.8 billion. This represented 56 percent of the \$5 billion raised by over 1,000 firms through managed public offerings. Two regional broker-dealers managed 92 percent of all offerings of less than \$10 million in annual revenues. Three broker-dealers also managed 82 percent of their offerings of natural resources and high technology firms.

When you really consider the impact that this could have on our total capital formation process, I would think that we would want to think very hard and very carefully about it.

I would be delighted to have Dr. Kaufman talk on the interest cost savings.

INTEREST COST SAVINGS

Dr. KAUFMAN. We were hired by the Securities Industry Association in 1978, to review a study done by Prof. Philip Cagan for the Dealer Bank Association, which found very large savings—amounting to, I believe, over \$400 million in present value—in 1977 alone.

We subjected the Cagan test to careful scrutiny, and we found three major flaws in the analysis:

One, there were serious errors in the classification of bank eligibility. Approximately one-quarter of the bonds in Cagan's sample were incorrectly classified.

Two, he used an incompletely specified economic model that statistically confused bank eligibility with other characteristics of the bonds that were not specified in the model.

Three, he assumed—contrary to the evidence, Senator Dixon—that bank eligibility would cause State and local governments to sell more by competitive bid than by negotiation.

We corrected each of these errors. The commercial bank eligibility status of each bond in Cagan's own sample was determined by the respected independent bond counsel firm of Wood-Dawson. We insisted on that. We did not want to have anybody who was not a bond counsel classify the bank eligibility for this study.

Cagan's basic econometric model was extended, to control for all possible characteristics of municipal revenue bonds.

Most importantly, we included the purpose for which the bond was issued—or example: housing, hospital, parking facilities—a characteristic that the market uses to determine the credit quality of the issue, in addition to the letter credit rating that is provided by the major rating agencies.

When these corrections are made, Cagan's own sample of municipal revenue bonds sold between 1973 and 1976 shows no statistically significant interest cost differences between bank-eligible and bank-ineligible bonds, either sold by negotiation or by competitive bid. Moreover, these findings are even more conclusive when the analysis is updated to include revenue bonds sold in 1979.

There is a possibility that the result we found for 1973-76, even though we used Cagan's own sample, can be unique to that period. We were asked, after we completed the first study, to undertake a second study and see if the results held up or were different for 1979.

When we applied the data for 1979 to Cagan's old, abbreviated model—not the expanded model that we used—we found that for competitively sold bonds, bank-eligible bonds had a higher interest rate than bank-ineligible bonds, because there were fewer bidders than for comparable bank-eligible bonds.

Now, I find that result implausible. I do not believe that bank eligibility would increase interest rates.

When we expanded the model—as we had done earlier for 1973-76—when we expanded it to look at the 1979 data, we found exactly the same results that we had found for the earlier periods. There was no statistical significant difference in the interest costs on bank-eligible and bank-ineligible bonds.

Consequently, we conclude that bank eligibility would have no effect, one way or the other, on the interest costs on municipal revenue bonds.

Senator DIXON. One would have to conclude, as a layman, from your study that what you are testifying to here is that enlarging competition makes no difference in price.

Dr. KAUFMAN. No, sir. I do not believe that that is the case.

Senator DIXON. It happens to be, though, what you draw as a conclusion—as a lay person—from the suggested result of your study, I think.

Dr. KAUFMAN. Let me answer that as follows.

There are two possibilities where you could have reduced interest rates:

One, there is not sufficient competition among underwriters now. That is a conclusion that Professor Cagan did not make in his own

study. He found that only \$7 million of the \$400 million came from a reduced underwriter profit.

The other possibility is that the greater number of underwriters are going to sell the bonds at a higher price, not a lower price, because interest rates and bond prices, as you know, are inversely related. So, if you reduce interest rates you increase the price of the bond.

Now, if you suddenly have a new grocery store coming into your area, you would expect that the prices of the products at the grocery store are going to be lowered. It is very difficult to imagine that if you have an increased number of sellers of bonds selling to the investors, that they would be selling them at a higher price, not a lower price.

As a result, the first person to have looked at this was Prof. Rubin Kestler at the University of Chicago, in 1971. He concluded that if competition did not raise the price, then why else care. He had a very fertile imagination, and concluded that what would happen is that the underwriters are going to find new customers, new investors, who would be willing to buy these bonds at a higher price.

Now, you have to assume that there are major investors who have never heard of Merrill Lynch and Goldman Sachs, and some of these very pussycat and nonaggressive firms that are on this table; so that, if you do not assume that there are significant numbers of investors who had never heard of these firms, who do not buy equities—after all, if they buy equities, they could only deal at the moment with the investment banking community, not with the commercial banking community—then it makes logic and good economic theory that increased competition would lower the price of bonds, not raise them.

But one has to remember that investors are middlemen. They buy the bonds from the State and local issuers, and they sell them to investors. If you believe there is competition on both sides, not just one side, competition on the side where they buy the bonds from the issuer, and then competition on the selling side, the two should offset each other and there should be no net effect.

We do not believe that there is any contradiction of economic theory here, sir.

Senator DIXON. You have been extremely helpful. [Laughter.]

Mr. CRAIGIE. Would you like to hear from Dr. Mussa, or would you pass?

Senator DIXON. Well, if the Chair thinks it will help him, I'm willing to listen.

The CHAIRMAN. No. [Laughter.]

I think we had better move on.

I think the statement that applies here is that:

I am sure that you understand what I think I said, but I am not sure that you realize that what I said is not what I meant.

I do think, though, we have got to move on quickly. We still have another panel.

I do think Mr. Schneider should be given the opportunity to respond on this question, hopefully not in the detail that the other side has had.

Mr. SCHNEIDER. Not being an economist, I will try to be brief.

There are a few points, I believe, that need to be made, to put the previous questions and answers in context.

There was an allegation made that somehow bank participation in the underwriting of the Washington Public Power System bonds helped raise the interest rate to a 15-percent level. It should be understood by everybody that the manager of that syndicate was Merrill Lynch. That was a \$750 million issue, the largest issue ever. Every broker-dealer in the country was involved in it, and nearly every bank dealer was involved in it.

The people who were issuing the bonds were happy to get the money at any price, and they thought it was very, very fair under the circumstances of the credit problems that had occurred there. That was really the reason for the 15 percent, combined with a very difficult time in the market; and it had nothing to do with banks being able to underwrite that issue.

There were also statements made that somehow investment activities of banks have gotten them into trouble. And if I heard it right, it sounded as though it was risky for banks to invest in Government bonds—U.S. Government bonds. I do not really think that that was what was meant—at least I hope that was not what was meant.

Of course, those banks that got themselves into difficulty really were operating on the investment side, not on the trading side. What we are talking about here is owning a revenue bond for 10 minutes. We already have the authority, as a bank, to own a revenue bond for 10 months or 10 years. I think in many ways, holding it for 10 minutes is less risky than the basic lending and investment activity that we are already involved in.

BANKS NEED SMALL DEALERS

A point about small dealers. Suddenly, the introduction of bank competition is going to be terrible for small dealers. We are all concerned about small dealers. There are plenty of small shoe stores in this country that operate very well in the face of Sears selling shoes and shoes being sold mail order; and still, the small store operates very well.

Don't you think that the small dealer presently is operating in the face of Merrill Lynch competition and Goldman Sachs competition, and offices all over the country—Bache—or should I say Sears and Prudential? I'm not sure which name I'm supposed to use. And yet, the small dealer continues to survive today, and to survive very well.

I might also add that the banks need the small dealers more than the large securities firms, because banks typically operate out of one office; whereas Merrill Lynch and Goldman Sachs and Dean Witter, and so on, operate out of offices all over the country. We need the local distribution of the small dealers. We need the small dealers' contact with the local issuers. We need to work together with them.

We are much more helpful to the small dealer than Merrill Lynch or Dean Witter is.

The last point, relating to savings and economists: It should be clear that Professor Cagan is not the only economist who has ever studied this issue. He is the one that the securities industry seems

to talk about the most, because they have done the most work in trying to re-do his statistics.

The point is not a subtle statistical analysis; the point is a broad one. Virtually every economic study that has been done—and there have been many done by the Federal Reserve, by Prof. Richard West, and by many others, over a lot of years—every study that has been done shows that there are savings.

They vary in amounts, but it shows that there are savings, and it should not be surprising that economists really do agree with commonsense.

I would like to do something that I am not sure is permitted under the rules. I would like to quote an economist that we have not paid for, that we have not hired.

Last week, Herbert Stein, the distinguished former Chairman of the President's Council of Economic Advisors and professor at the University of Virginia, talking about a different economic issue, said that we have difficulty, as laymen, in ferreting out economic questions because the media serves to help bad talk drive out the good.

He said you could have an economic issue on which on one side—15,000 economists, and every living president of the American Economic Association—agree, and on the other side, 6 people, including 2 economists, take the contrary view and the media comes in and says, well, economists are in disagreement on this issue, and let's get a representative of each side, and then we will report the opposing side views? And somehow, in the attempt to create a fairness, the real balance is lost to the laymen. I think that is what has really happened here.

The CHAIRMAN. Thank you, Mr. Schneider.

I am convinced of one thing after this last interchange: That I do not understand all I know about this subject.

We do have a vote going. We will have to submit some questions to you for your response in writing.

Not only do we have another panel, but Senator Dixon and I will both have to go.

Let me make one comment about this issue. Without any facts, without any statistics to back me up, without any economists:

I firmly believe it would save the cities of this country money—and I say that from the standpoint of a former mayor, because I had a great deal to do with the competitive bidding process, not only in construction projects but tax anticipation notes and a lot of financial instruments.

I have a gut feeling that the professors can discount at will, but professors did not run cities; mayors did, and do. Some things do not fit all of the rules of the econometric models, and so on. I cannot imagine trying to negotiate tax anticipation notes and other financial instruments. There is no doubt in my mind that there was intense bidding—just our tax anticipation notes. I cannot believe that the same thing would not be true in municipal revenue bonds, where we would see a much greater competitive situation if people had to bid on them.

I really want to go back over what you said, because it was very impressive. But I'm going to have to read it and underline it, to go through it.

I do apologize for the vote occurring.

I very much appreciate all of your testimony and your willingness to be here today. And we will undoubtedly be submitting some questions to you for your response.

Thank you very much. If the next panel would come forward, then we will vote, the committee will be in recess for about 15 minutes.

[Recess.]

The CHAIRMAN. Back on the record.

I apologize, gentlemen, for the interruption, but we cannot control the lights and the bells. We are happy to have you with us.

STATEMENTS OF WILLIAM H. HUDNUT III, PRESIDENT, NATIONAL LEAGUE OF CITIES; RICHARD CONDER, PRESIDENT, NATIONAL ASSOCIATION OF COUNTIES; AND WILLIAM REYNOLDS, PRESIDENT, MUNICIPAL FINANCE OFFICERS ASSOCIATION

The CHAIRMAN. Mayor Hudnut, would you like to proceed?

Mr. HUDNUT. Thank you very much, Mr. Chairman.

I am Bill Hudnut, mayor of Indianapolis and president of the National League of Cities, which represents, either directly or indirectly through membership in State municipal leagues and our organization, some 15,000 cities of all sizes and geographic locations.

I do not have to tell you that. You used to be one of us.

The CHAIRMAN. They have not even changed the speech. I thought maybe we would get to 16,000 or something. I used to make the same pitch myself. [Laughter.]

Mr. HUDNUT. I might say before I start, that I am sorry my distinguished predecessor as mayor of Indianapolis, Richard Lugar, cannot be with us. He is one of the most esteemed citizens that the Hoosier State has ever produced.

The CHAIRMAN. I would interrupt and say Dick and I served on the National League of Cities board of directors together. I was fortunate enough to be able to participate in the coup in Los Angeles, when Dick was first or second vice president, and we beat John Lindsay on the floor of the convention.

Mr. HUDNUT. He was in the air, on his way back to New York, thinking he had won.

The CHAIRMAN. So Dick returned the favor in 1974. The convention was in Indianapolis. I became second vice president of NLC, although I got a much better deal than you, because I never did serve as president. I was due to become president 3 weeks after I got elected to the Senate. They gave me a better deal. They made me honorary president of the National League of Cities for 1975, and gave me a beautiful plaque for how much they missed my leadership; and I didn't have to do anything. It was better than they ever gave a president who actually served. I got the best of all worlds.

Mr. HUDNUT. Well, Senator, I have been told that you hold the record for having been the president of NLC for the shortest length of time of anybody in the history of the organization. I am glad that you have had the privilege to serve the people of your State more than one day over here.

The CHAIRMAN. Thank you.

Mr. HUDNUT. We are very honored that we have been invited to make a presentation on the legislation that you and Senator Lugar have introduced, S. 1720 and S. 1686. We are here to state our support for this legislation, to express the hope that it will be enacted into law, and to express the further hope that the other body—where I was privileged to serve at one time—will also act positively on the ideas contained in your bills.

We are very grateful for the chance to express what has been our position for more than 15 years, and is part of our formal municipal policy, with regard to title III of S. 1720. We don't feel that we have the competence to speak on the entire bill, which is a very complex piece of legislation.

With reference to title III, we strongly favor it. It would permit commercial banks to underwrite and deal in investment quality municipal revenue bonds. We are heartily in favor of that.

As we all know, since 1933 there has been a great increase in the utilization of municipal revenue bonds. At that time, when the Glass-Steagall Act was enacted, banks were expressly permitted to underwrite and deal in general obligation bonds. The use of revenue bonds was virtually nonexistent. It is different now, as you know because of your familiarity with the cities.

REVENUE BONDS

State and local governments and other public authorities use revenue bonds now to finance numerous essential public projects—roads, bridges, public transit, airports, water and sewer projects, public power systems, and all types of public buildings. I believe we are headed toward a national crisis when it comes to maintaining the infrastructure of this country, which is deteriorating, because cities are organisms just like people are, and we get older.

This legislation comes at a time when the Federal Government is essentially cutting back funding for such projects, and when local voters are growing increasingly resistant to add-ons to their general property taxes, another reason why we are in favor of this legislation.

It makes a great deal of sense to us that there be the greatest potential number of buyers and sellers of these revenue bonds, to keep costs down for issuers and their taxpayers, and to assure that capital is available to handle the demands on the market.

As has been obvious this morning, there has been conflicting testimony presented to you about the extent of the savings that will be realized if commercial banks are allowed to underwrite revenue bonds. Some of my friends tell me there will be savings; others tell me there won't be. I am for my friends, Mr. Chairman.

Our organization, the National League of Cities, is convinced that savings will result, for the commonsense reason that the laws of economics, it seems to us, will govern these transactions and generally lower the costs through more competition.

Along the same line, we have heard another curious argument against this legislation. It should not be passed, it is said, unless it can be proven beyond doubt that savings will result. We would offer you this, sir: We think the burden of proof should rightly fall

on those who seek to limit competition, rather than on those who wish to expand it.

We also feel that if S. 1686, which is being introduced by your distinguished colleague and my distinguished predecessor as mayor of Indianapolis, Richard Lugar, were to be incorporated into S. 1720, that it would add strength to that bill. We certainly hope that will be considered by you and by the members of your committee.

S. 1686 will certainly aid State and local governments in improving their cash management practices. We appreciate Senator Lugar's initiative and hope that it will be folded into S. 1720.

Two changes in banking practices would result from this bill, both of which we think are significant:

First, State and local general purpose governments would be permitted to establish NOW accounts, checking accounts with interest, at financial institutions.

And second, it would allow State and local governments to deposit idle funds in financial institutions on demand, and earn interest at rates slightly below the Federal funds rate. We are in favor of that.

We think it is important to clarify the wording in the Deregulation and Monetary Control Act of 1980. As we all know, there was some ambiguity about what was meant by such phrases as "not operated for profit." That is at the heart of the dispute. General purpose State and local governments are not for profit; but can they establish NOW accounts?

To clear up the dispute, we would hope that this bill would be enacted into law to make it very clear, unequivocally, in the statute—which we think would be in keeping with the spirit of the 1980 act—that State and local general purpose governments ought to be permitted to use NOW accounts because they are nonprofit entities.

S. 1686, which is neutral with respect to which governments can have access to NOW accounts, and which financial institutions can offer them, would help clear the air.

The second feature of S. 1686 has no previous controversy associated with it. It would permit State and local governments to do what the Federal Government can already do: deposit funds in financial institutions on demand at interest rates slightly below the average Federal funds rate. It would remove the reserve requirements on State and local government deposits, but require that such deposits be secured by U.S. Government, government agency, or municipal securities, and permit higher interest rates to be paid on the deposits.

It would treat State and local funds the same as Federal funds. We think that is not only appropriate but in the interest of justice and equity.

Let me say one more word. We represent, as we mentioned, cities of all sizes. We represent a lot of small cities throughout the country, Mr. Chairman, and as we all are aware, small cities do not usually have the staff to carry on sophisticated cash management programs. Sometimes they lack sufficient fund balances to make the high-interest investments that a large city can make routinely.

I think this bill will help the small cities of our country substantially, which is another reason why we are in favor of it. It will help them in their cash management capabilities.

It is not very often that we can appear before your committee to make three requests for legislation that will not cost the Federal Government any extra money. We have done so today, in the interest of saving local governments money. These are good government proposals, and we hope you will act on them soon.

Thank you very much.

[Complete statement follows:]

STATEMENT OF WILLIAM H. HUDNUT III, MAYOR, CITY OF INDIANAPOLIS AND
PRESIDENT, NATIONAL LEAGUE OF CITIES

Mr. Chairman and Members of the Committee, I am Bill Hudnut, Mayor of Indianapolis and President of the National League of Cities. As you know, NLC represents about 15,000 cities across the country directly and through membership in state municipal leagues. Our nearly 1,000 direct member cities are as diverse in size and character as New York City and Sun Valley, Idaho.

Thank you for asking us to appear before you to present our views on legislation your Committee is considering to deregulate and restructure financial institutions. Since we at NLC do not consider ourselves banking experts and, therefore, are not qualified to comment on all aspects of the four bills before you, we wish to limit our remarks to Title III of S. 1720 authored by you, Mr. Chairman, and S. 1686 introduced by Senator Lugar.

Before proceeding, though, let me make one general observation with respect to the broader question of deregulation of the savings and loan industry. We welcome this examination of S and L's by the Senate Banking Committee in an effort to find solutions to the current problems of the industry. During NLC's unsuccessful fight to kill All Savers Certificates (a measure that we still contend was poor tax policy), we were accused of being anti-S and L and anti-housing. Nothing could be further from the truth. Cities have always worked to develop and maintain strong housing programs and policies in this country, but we did not see that All Savers would either help housing appreciably or solve the real problems of the S and L industry, to say nothing of the damage they will do to the municipal bond market.

We hope that you will be successful in finding ways to enable the S and L industry to remain viable, not just to prevent other poorly-structured solutions such as All Savers Certificates in the future, but to provide a continuing source of affordable housing credit for housing acquisition and rehabilitation.

My primary purpose here today is to voice our strong support for Title III of S. 1720, which would permit commercial banks to underwrite and deal in investment quality municipal revenue bonds. NLC has supported such legislation for more than 15 years and has included a formal statement to that effect in our National Municipal Policy adopted annually by our membership. If that policy made sense the first time we adopted it, our wisdom has only increased with age because this relatively simple change in law has never been needed more than it is today. Let me explain.

Since 1933 when the Glass-Steagall Act was enacted, there has been substantial change in the municipal bond market. At that time, banks were expressly permitted to underwrite and deal in general obligation bonds. This was not the case with revenue bonds, but they were virtually non-existent then. In 1933, nearly all local government construction projects were financed with general obligation bonds and very few with revenue bonds. By 1960, tax-exempt revenue bond volume was still only about \$2 billion annually or less than one-fourth of the long-term market. Ten years later, revenue bond volume had grown to a third of the total bond market, but in 1980, revenue bond volume was fully 70 percent of the market.

Revenue bonds now dominate the municipal bond market, a fact that is not likely to change. Whereas the Glass-Steagall Act may have been suitable for the times in 1933, it now serves to hinder cost-effective means of issuing revenue bonds.

State and local governments and other public authorities use revenue bonds for financing such essential public projects as roads, bridges, public transit, airports, water and sewer projects, public power systems, and all types of public buildings. I believe we are headed toward nothing short of a national crisis in being able to build and maintain the infrastructure of this country. And it comes at a time when the Federal Government is substantially cutting funding for such projects and when local voters are growing increasingly resistant to add-ons to their general property taxes.

Whenever possible, state and local officials will seek to do public works projects only when a direct fee or service charge from a project can be identified as a revenue source. This means using revenue bonds to finance the projects. However, the costs of construction projects have skyrocketed due to inflation and interest rates on bonds are through the roof. It only makes sense that there be the greatest potential number of buyers and sellers of these revenue bonds as possible to keep costs down for issuers and their taxpayers and to assure that capital is available to handle the demands in the market.

You no doubt have heard conflicting arguments about how much money State and local governments can expect to save if commercial banks are allowed to underwrite revenue bonds. We are uncertain of the amount, but we are convinced that savings will result because common sense tells us that the laws of economics will govern and lower costs will result from more competition.

Let me remind the Committee that in the bond business small fractions translate into big dollars. A difference of only two-tenths of one percent of interest on a \$25 million, 25-year bond computes to a \$650,000 difference over the life of the issue, for example, a sum not insignificant to local taxpayers.

Along this same line, we have heard another curious argument that this legislation should not be passed unless it can be proven beyond doubt that savings will result. To that fallacious reasoning, our response is that the burden of proof should rightfully fall on those who seek to limit competition rather than on those who wish to expand it.

I want to point out, too, that the current number of competitors for our revenue bond business is not staying constant but is actually declining. Since 1970, over 350 securities firms have disappeared, usually because of mergers. It seems to us that the shrinking number of firms in the industry cannot be in the best interest of the issuers who are seeking the lowest possible cost of issuance. Entry of commercial banks into the market would open up the pool of competitors for our business.

We are aware that on two previous occasions the Senate has passed legislation similar to Title III of S. 1720. It is in the House where many attempts over the last decade to get this legislation enacted have been stymied. However, another bill has been introduced this year and as of October 15, 208 Members have added their names as co-sponsors. Perhaps, with this broad support, your help now in moving the issue along, plus the legislation's obvious good sense in its favor, we can at last win passage.

Turning now to S. 1686, I want to first commend my own Senator and predecessor as Mayor of Indianapolis, Dick Lugar, for sponsoring this bill. It will certainly aid State and local governments in improving their cash management practices, and I appreciate his making this initiative.

S. 1686 would make two changes in banking practices: First, State and local general purpose governments would be permitted to establish NOW accounts, or checking accounts with interest, in financial institutions. Second, it would allow State and local governments to deposit idle funds in financial institutions on demand and earn interest at rates slightly below the Federal funds rate.

You will recall that when the Depository Institutions Deregulation and Monetary Control Act of 1980 was passed, it permitted certain organizations, we well as individuals, to establish NOW accounts. The law states specifically that NOW accounts are available to "an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit." The meaning of this language has been the subject of some debate ever since the law was passed.

At the heart of the dispute is the question of whether general purpose State and local governments can establish NOW accounts. A literal reading of the language seems to indicate that they cannot. On the other hand, it has been argued that school districts or libraries, if their funds are kept separate from general purpose funds, could establish NOW accounts.

The debate boiled over recently when the Federal Home Loan Bank Board issued a regulation permitting savings and loans to offer NOW accounts to all State and local governments at the same time the Federal Reserve Board proposed that banks could not offer such accounts. The FHLBB regulation was quickly challenged by the American Bankers Association which was successful in winning a U.S. District Court permanent injunction prohibiting State and local government participation in NOW accounts.

NLC's position in all this has been straight-forward. We think State and local general purpose governments ought to be permitted to use NOW accounts since they are non-profit entities, which is in the spirit of the 1980 Act. Moreover, we think it would be silly to permit some local governments to have them and not

others and disruptive to allow some financial institutions to offer them and not others.

S. 1686 would clear the air. It is neutral with respect to what governments can have access to NOW accounts and which financial institutions can offer them. It improves the 1980 Act by making an expressed provision for NOW accounts for State and local governments.

The second feature of S. 1686 has no previous controversy associated with it. It would permit state and local governments to do what the Federal Government can already do—deposit funds in financial institutions on demand at interest rates slightly below the average Federal Funds rate. State and local government demand deposits currently are subject to reserve requirements and cannot earn a rate of interest higher than the rate paid on NOW accounts.

S. 1686 would remove the reserve requirements on state and local government deposits but require that such deposits be secured by U.S. Government, Government Agency, or municipal securities. In addition, it would permit the higher interest rates on the deposits. The bill would treat state and local government funds the same way federal funds are handled.

While these two changes would be beneficial to all governments, I want to emphasize that they would be particularly advantageous to small cities. Small cities do not usually have the staff to carry on sophisticated cash management programs. They also sometimes lack sufficient fund balances to make high-interest investments that large cities can make routinely. Both measures contained in S. 1686 are easy to use and give small cities better tools to assure that temporarily idle funds are invested at the maximum return possible.

Mr. Chairman, it is not very often that we can appear before this Committee to make three requests for legislation that will not cost the Federal Government any money. We have done so today in the interest of saving local governments money. These are "good government" proposals that we hope you will act on soon.

The CHAIRMAN. Thank you.

Mr. Conder?

Mr. CONDER. Thank you very much for giving me this opportunity to appear before you today, to testify in support of your bill, Senate bill 1720.

As you have stated, my name is Richard Conder. I am chairman of the board of commissioners in Richmond County, N.C. I am also president of the National Association of Counties, and I am appearing here on NACo's behalf.

NACo, as you probably know, represents approximately 2,200 counties in America today, which represents in excess of 85 percent of the total population of this country.

Mr. Chairman, at the outset of my statement, I want to point out that NACo first reviewed this issue and adopted a policy of support in May of 1977. Since that time, our policy has been reaffirmed annually and reflects a consistent position that allowing commercial banks to underwrite public purpose municipal revenue bonds would enable State and local governments to realize savings by permitting increased competition in the municipal bond market.

The committee is well aware of the historical background of this issue. I will not burden you with restating that history other than to emphasize that the trend toward local government use of revenue bonds, rather than general obligation bonds, for vital public projects has been dramatic and steadily increasing since 1965. In 1980, revenue bonds totaled \$35 billion and constituted more than 70 percent of all long-term bonds sold by State and local governments.

The reasons for more intensive use of this debt instrument are rooted in the adverse fiscal conditions that have confronted local government in recent years:

LOCAL GOVERNMENT RESTRICTIONS

Twenty-six States have established tax limitations on their local governments;

Many others have limited increases in local governments;

Double-digit inflation has eroded the buying power of the local government service dollar; and

Voters frequently have rejected referenda for tax-supported capital expenditures by local governments.

In addition, numerous States have imposed ceilings on the amount of general obligation debt localities can incur. In my own State of North Carolina, for example, State law provides that total long-term general obligation indebtedness may not exceed 8 percent of assessed property valuation in counties.

Local governments faced with restrictions such as these have been forced to find ways of satisfying increased citizen demands for services with decreasing sources of revenue. Many of them have turned to revenue bonds as a financing tool for essential public purpose projects. This trend has been encouraged by some agencies within the Federal Government, particularly the Environmental Protection Agency, which has urged local governments to utilize revenue bonds in financing the construction of water and sewer treatment plants.

Counties in my State and the United States generally that have increased their issuance of revenue bonds have done so in an atmosphere of intense public scrutiny, one that demands fiscal prudence. Consequently, our counties have sought to issue these bonds at the least possible cost to local taxpayers.

The current prohibition of commercial bank underwriting of most types of revenue bonds has undermined the ability of our governments to save the public dollar because it has limited competition in the municipal bond market. It has ignored the fundamental and generally recognized economic principle that increased competition lowers costs in a market economy.

It is only common sense that dictates that the more supermarkets you see in a given area, the lower the cost of food is going to be.

Extensive testimony has been offered in earlier hearings on this issue, concerning the potential savings that would accrue to local government issuers through commercial bank underwriting of municipal revenue bonds. The conflicting conclusions reached by studies about the amount of these savings have been presented in detail.

I will not belabor these statistics or attempt to make a judgment concerning the accuracy with which savings have been estimated in these studies. Rather, I would emphasize that all the studies have indicated that some savings would be realized by local government issuers of revenue bonds, and no study has maintained that local governments would incur greater costs as a result of commercial bank entry into the revenue bond market.

Prof. William L. Silber of New York University reviewed and analyzed 12 of these studies in 1979. He concluded that the participation of commercial banks in underwriting and trading municipal revenue bonds would have resulted in savings to State and local governments of somewhere between \$150 and \$300 million in 1977.

That represents a substantial savings, but the potential for such savings is far greater today, given the current high rates of interest on municipal bonds and the increased volume of revenue bonds in the municipal bond market.

For county governments, the principal issue of interest in this legislation is savings. Viable financial management by our counties demands utilization of all sources of savings to taxpayers, regardless of the dollar amount of such savings.

And the importance of savings to counties and to governments generally has increased considerably since the advent of the Reagan economic program. Under the program, Federal aid to local governments has declined substantially. In the block grant area alone, cuts have been severe.

The 58 programs that were consolidated into 9 block grants were cut by 25 percent. It is possible that the costs of State administration of these programs could amount to as much as 10 percent and, if the inflation rate continues at 10 percent or above, a total of 45 percent could be effectively cut from these programs. The administration is currently proposing an additional cut in Federal programs of between \$5 to \$6 billion, and local governments will bear a large portion of the burden of this additional cut.

DECREASING FEDERAL AID TO LOCAL GOVERNMENTS

I wish to point out that decreasing federal aid to local governments most likely will not be replaced by State aid, since States themselves are experiencing substantial Federal cutbacks. Furthermore, the 35 States whose corporate income tax structures are tied to the Federal income tax structure and the 10 States that have adopted some form of Federal depreciation schedules face an additional \$2 billion revenue loss in 1982.

Because of these factors, the National Governors' Association has concluded that many States will incur a deficit in the coming year.

Local governments, including counties, must look to themselves to deal with these reductions in intergovernmental aid.

One tool they can utilize is effective debt management, that is, responsibly issuing debt for only the most necessary and worthy public projects at the lowest possible cost and expense to the taxpayer. In recent years, this has become increasingly difficult.

Interest rates in the municipal bond market have risen to record highs because of a combination of inflation and crowding out due to the large volume of tax-exempt issues. Yields on municipal revenue bonds have almost doubled in the past 2 years. In September 1979, at the time the "bond buyer" 30-year revenue bond index was established, rates on long-term revenue bonds were at 7.23 percent. They rose relatively steadily, with a brief respite in the summer of 1980, to a high of 14.25 percent last September 11. Since that time, they have dropped slightly.

Several factors have driven rates up, most influential among them being imposition of credit controls by the Federal Government in late 1979 and early 1980, continued double-digit inflation, and increased volume of issues, including Federal Treasury issues.

Although Federal credit controls have been withdrawn, the remaining two factors will probably continue to operate in the municipal bond market:

Inflation may remain in the double-digit range; and

The large volume of Federal Treasury borrowings is unlikely to abate.

Henry Kaufman of Solomon Brothers has estimated recently that the Treasury will need to borrow between \$60 and \$65 billion during the next 6 months. Clearly, the need for such massive financings will maintain the fierce competition for investors among tax-exempt issuers, including counties, that wish to issue revenue bonds.

This does not bode well for interest rates on long-term securities or State and local governments, or for the ability of these governments to market these securities effectively.

I hope my remarks make clear that reductions in intergovernmental aid and adverse conditions in the municipal bond market have combined to make the potential savings that would accrue to state and local governments through commercial bank underwriting of municipal revenue bonds more vital than ever before.

That is why the National Association of Counties enthusiastically supports this legislation, which it considers to be essentially a deregulation measure designed to remove dated and needless restrictions from commercial banks.

We view it as an effort by Congress to enable state and local governments to respond in a dynamic and responsible way to the challenges of the administration's economic program by making available to them the necessary debt management tools.

While discussing this issue from the perspective of deregulation, let me mention briefly legislation that contains another deregulatory measure——

The CHAIRMAN. If I could interrupt here and ask you if we could put the rest of your statement in the record. There is another vote. And I would like to give Mr. Reynolds an opportunity to testify. I hate to do that to you, but if you would not mind, I don't want to cut Mr. Reynolds off.

Mr. CONDER. Can I make one statement? I would be remiss if I did not publicly thank you for your leadership and support of general revenue sharing on behalf of county government in America. Thank you.

[Complete statement follows:]

STATEMENT OF RICHARD CONDER, CHAIRMAN OF THE BOARD OF COMMISSIONERS, RICHMOND, AND PRESIDENT, NATIONAL ASSOCIATION OF COUNTIES ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES

Mr. Chairman and distinguished Members of the Committee, I appreciate the opportunity to appear before you today to testify in support of S. 1720, legislation which would authorize commercial banks to underwrite and deal in state and local government revenue bonds for public purposes.

I am Richard Conder, Chairman of the Board of Commissioners of Richmond, North Carolina. I am also President of the National Association of Counties (NACo)¹ and am appearing on behalf of NACo today.

Mr. Chairman, at the outset of my statement, I want to point out that NACo first reviewed this issue and adopted a policy of support in May of 1977. Since that time, our policy has been reaffirmed annually and reflects a consistent position that

¹ The National Association of Counties (NACo) is the only national organization representing county government in the United States. Through its membership urban, suburban and rural counties join together to build effective, responsible county government.

The goals of the organization are to: improve county government; serve as the national spokesman for county government; act as a liaison between the nation's counties and other levels of government; achieve public understanding of the role of counties in the federal system.

allowing commercial banks to underwrite public purpose municipal revenue bonds would enable state and local governments to realize savings by permitting increased competition in the municipal bond market.

The Committee is well aware of the historical background of this issue. I will not burden you with restating that history other than to emphasize that the trend toward local government use of revenue bonds, rather than general obligation bonds, for vital public projects has been dramatic and steadily increasing since 1965. In 1980, revenue bonds totaled \$34 billion and constituted more than 70 percent of all long term bonds sold by state and local governments.

The reasons for more intensive use of this debt instrument are rooted in the adverse fiscal conditions that have confronted local government in recent years. Twenty-six states have established tax limitations on their local governments; many others have limited increases in local government expenditures; double-digit inflation has eroded the buying power of the local government service dollar; and voters frequently have rejected referenda for tax-supported capital expenditures by local governments. In addition, numerous states have imposed ceilings on the amount of general obligation debt localities can incur. In my own state of North Carolina, for example, state law provides that total long term general obligation indebtedness may not exceed eight percent of assessed property valuation in counties.

Local governments faced with restrictions such as these have been forced to find ways of satisfying increased citizen demands for services with decreasing sources of revenue. Many of them have turned to revenue bonds as a financing tool for essential public purpose projects. This trend has been encouraged by some agencies within the federal government, particularly the Environmental Protection Agency, which has urged local governments to utilize revenue bonds in financing the construction of water and sewer treatment plants.

Counties in my state and the United States generally that have increased their issuance of revenue bonds have done so in an atmosphere of intense public scrutiny, one that demands fiscal prudence. Consequently, our counties have sought to issue these bonds at the least possible cost to local taxpayers. The current prohibition of commercial bank underwriting of most types of revenue bonds has undermined the ability of our governments to save the public dollar because it has limited competition in the municipal bond market. It has ignored the fundamental and generally recognized economic principle that increased competition lowers costs in a market economy.

Extensive testimony has been offered in earlier hearings on this issue concerning the potential savings that would accrue to local government issuers through commercial bank underwriting of municipal revenue bonds. The conflicting conclusions reached by studies about the amount of these savings have been presented in detail. I will not belabor these statistics or attempt to make a judgment concerning the accuracy with which savings have been estimated in these studies. Rather, I would emphasize that all the studies have indicated that some savings would be realized by local government issuers of revenue bonds, and no study has maintained that local governments would incur greater costs as a result of commercial bank entry into the revenue bond market. Professor William L. Silber of New York University reviewed and analyzed twelve of these studies in 1979. He concluded that the participation of commercial banks in underwriting and trading municipal revenue bonds would have resulted in savings to state and local governments of somewhere between \$150 million and \$300 million in 1977. That represents a substantial savings, but the potential for such savings is far greater today, given the current high rates of interest on municipal bonds and the increased volume of revenue bonds in the municipal bond market.

For county governments, the principal issue of interest in this legislation is savings. Viable financial management by our counties demands utilization of all sources of savings to taxpayers, regardless of the dollar amount of such savings. And the importance of savings to counties and to governments generally has increased considerably since the advent of the Reagan economic program. Under the program, federal aid to local governments has declined substantially. In the block grant area alone, cuts have been severe. The 58 programs that were consolidated into nine block grants were cut by 25 percent. It is possible that the costs of state administration of these programs could amount to as much as 10 percent, and, if the inflation rate continues at 10 percent or above, a total of 45 percent could be effectively cut from these programs. The administration is currently proposing an additional cut in federal programs of between \$5 to \$6 billion, and local governments will bear some portion of the burden of this additional cut. I wish to point out that decreasing federal aid to local governments most likely will not be replaced by state aid, since states themselves are experiencing substantial federal program cutbacks. Furthermore, the 35 states whose corporate income tax structures are tied to the federal

income tax structure and the 10 states that have adopted some form of federal depreciation schedules face an additional \$2 billion revenue loss in 1982. Because of these factors, the National Governors' Association has concluded that many states will incur a deficit in the coming year.

Local governments, including counties, must look to themselves to deal with these reductions in intergovernmental aid. One tool they can utilize is effective debt management, that is, responsibly issuing debt for only the most necessary and worthy public projects at the lowest possible expense to the taxpayer. In recent years, this has become increasingly difficult. Interest rates in the municipal bond market have risen to record highs because of a combination of inflation and "crowding out" due to the large volume of tax-exempt issues. Yields on municipal revenue bonds have almost doubled in the past two years. In September 1979, at the time the Bond Buyer 30-year Revenue Bond Index was established, rates on long term revenue bonds were at 7.23 percent. They rose relatively steadily, with a brief respite in the summer of 1980, to a high of 14.24 percent last September 11. Since that time, they have dropped slightly. Several factors have driven rates up, most influential among them being imposition of credit controls by the federal government in late 1979 and early 1980, continued double-digit inflation, and increased volume of issues, including federal Treasury issues. Although federal credit controls have been withdrawn, the remaining two factors will probably continue to operate in the municipal bond market. Inflation may remain in the double-digit range and the large volume of federal Treasury borrowings is unlikely to abate. Henry Kaufman of Solomon Brothers has estimated recently that the Treasury will need to borrow between \$60 and \$65 billion during the next six months. Clearly, the need for such massive financings will maintain the fierce competition for investors among tax-exempt issuers—including counties—that wish to issue revenue bonds. This does not bode well for interest rates on long term securities of state and local governments or for the ability of these governments to market these securities effectively.

I hope my remarks make clear that reductions in intergovernmental aid and adverse conditions in the municipal bond market have combined to make the potential savings that would accrue to state and local government through commercial bank underwriting of municipal revenue bonds more vital than ever before. That is why the National Association of Counties enthusiastically support this legislation, which it considers to be essentially a deregulation measure designed to remove dated and needless restrictions from commercial banks. We view it as an effort by Congress to enable state and local governments to respond in a dynamic and responsible way to the challenges of the Administration's economic program by making available to them the necessary debt management tools.

While discussing this issue from the perspective of deregulation, let me mention briefly legislation that contains another deregulatory measure, one that would enable state and local governments to perform their cash management and investment functions more effectively. Senator Lugar recently has introduced S. 1686, a bill which would allow state and local governments to deposit surplus funds in financial institutions at interest rates slightly below the federal funds rate and also make these governments eligible to establish NOW accounts. Although NACo has not yet acted as a policy-making body to endorse this legislation, it appears clear that it warrants and will win our official support. Like the commercial bank underwriting issue now before us, this measure would permit state and local governments to realize significant additional revenues without cost to the federal government. It may behoove this Committee to combine these two measures in a single bill with the purpose of encouraging an effective response by state and local governments to the Administration's economic program.

To return to the subject at hand, it is our expectation that extending the privilege of underwriting municipal revenue bonds to commercial banks will produce savings for state and local government issuers in three ways: First, through broadening the "crowded" market I earlier described by bringing into it (through commercial bank activity) more individuals and institutions eligible to purchase municipal revenue bonds; second, by increasing competition among underwriters in the market and thereby reducing issuing costs to state and local governments; and third, by improving the liquidity of municipal revenue bonds and thereby lowering the interest rates for these bonds. As I mentioned earlier, it is difficult to predict accurately the exact dollar amount of these potential savings in the absence of evidence from the actual experience of unrestricted commercial bank underwriting of revenue bonds; however, we are confident that there are substantial savings to be gained.

It is important to point out that passage of S. 1720 would permit the realization of these savings by states and local governments while carefully structuring commercial bank underwriting of and trading in revenue bonds. The provisions in the

legislation that limit commercial banks' activities in this area are sufficiently protective, in our opinion, to prevent fraud and abuse. In this context, I would like to mention that while we were delighted to learn that the Administration has endorsed the concept of commercial bank underwriting, we feel that the particular proposal they have recommended is not as responsive to the needs of state and local governments as is S. 1720. This is because the Administration proposal would require any commercial bank wishing to underwrite and deal in municipal revenue bonds to establish a separate broker-dealer subsidiary. For many small commercial banks, such an action would be difficult and expensive, so much so that cost of commercial bank underwriting would outweigh the benefits. These financial institutions effectively would be prevented from participating in municipal revenue bond underwriting. To the extent that they did not participate, the full potential for increased competition among underwriters would not be realized, and the potential savings to state and local government issuers would be reduced. It is our belief that the regulatory provisions contained in S. 1720 are sufficient to prevent abuses of the revenue bond underwriting privilege by commercial banks. We feel that further restrictions, such as those proposed in the Administration bill, might be excessive and discourage some financial institutions from underwriting municipal revenue bonds.

Let me conclude by urging the timely passage of S. 1720. The fiscal pressures on state and local government are mounting daily. Commercial bank underwriting of municipal revenue bonds is not an issue whose time has come; it is an issue whose time is past due. I hope that this Committee will act expeditiously to remedy that situation.

I appreciate having had an opportunity to address you today and I will be happy to respond to any questions you may have.

WILLIAM REYNOLDS, PRESIDENT, MUNICIPAL FINANCE OFFICERS ASSOCIATION

Mr. REYNOLDS. Mr. Chairman, my name is William J. Reynolds, president, Municipal Finance Officers Association and Comptroller, Greenwich, Conn., and like yourself, a former mayor.

I represent the Municipal Finance Officers Association which, in turn, represents some 9,000 members who are State and local government finance officers, appointed or elected officials and public finance specialists.

I appreciate the opportunity to appear before this committee, and I join with the others in thanking you for the opportunity and your patience in listening to our testimony through a long morning. I have made an effort to reduce this to an absolute minimum.

The CHAIRMAN. I apologize. I did not anticipate another vote this quickly.

Mr. REYNOLDS. I did, I guess.

We are concerned with—and wish an opportunity to comment on two pieces of legislation which we believe is in the best interests of State and local government.

The first bill which you have introduced, S. 1427, would permit commercial banks to underwrite revenue bonds. The second piece of legislation, S. 1686, has been introduced by Senator Lugar, and it would provide two opportunities for more efficient investment of State and local government cash balances.

Like our counterparts in the private sector, State and local government financial managers should always be seeking the most efficient management of our resources and, hopefully, we should have equal access to investment vehicles and investment markets.

Since 1973, the Municipal Finance Officers Association has supported bank underwriting legislation. We firmly believe such legislation assists us in reducing the interest costs in our revenue bond financing by providing additional competition in the marketing of such bonds. The two original reasons for our support of bank

underwriting of State and local revenue bonds continue to hold. First, revenue bonds are a large and growing part of the debt instruments offered by State and local governments. Back in 1973, when we first considered the question, revenue bonds comprised about 40 percent of all municipal bonds sold or about \$10 billion in annual volume.

Today, some 8 years later, revenue bonds represent, on an average, about 70 percent of all bonds sold or approximately \$34 billion a year. Obviously, any action that might enhance the market for these securities and lower the costs of borrowing without adverse side effects, is worthy of our support and implementation.

To fail to see improvements in the market for our obligations, especially when such a large and growing part of it is involved, would be irresponsible on our part. We cannot ignore the fact that an important segment of the underwriting industry is denied the opportunity to participate in what is now the major share of our market.

Second, it continues to be our belief that permitting banks to underwrite and deal in revenue bonds would promote competition for the securities and lower borrowing costs for issuers. As you know, a large number of studies have been conducted on this subject. It is our opinion that the weight of evidence continues to indicate that bank entry should add to the number of bids received on issues, and thereby lower the cost of borrowing. And I believe the chairman has indicated that he supports that.

We believe that our original estimates, October 16, 1973, of a reduction in reoffering yield of approximately 5 to 10 basis points continues to be in a range that could be reasonably expected.

Academics and others will continue to argue about how much would, in fact, be saved, and the comparative virtues of different methods of estimating those savings. What must be recognized is that all studies concede that there will be savings to the issuer. The amount from where we stand, although debatable, is not material. We need to cut our costs at the local level. As government officials, we all serve the same master, our common constituent, the taxpayer.

It is our mutual responsibility to provide needed government services in an effective and efficient manner. The Federal Government should not impede our efforts to improve the efficiency of government by retaining road blocks that exacerbate the fiscal pressures upon State and local governments.

MAIN ISSUE TODAY IS COMPETITION

The main issue before us today is competition. I believe, as does the current administration, that a competitive free market system is one of the basic principles of our economy. And MFOA believes that there will be significant savings through the introduction of bank competition in the revenue bond underwriting market.

The current prohibition on commercial bank underwriting imposes hidden costs on State and municipal revenue bond issuers and, ultimately, on the taxpayers. At the same time, we can ill afford to absorb such costs. Incidentally, there are hidden costs occurring to the Federal Government also when we have to pay

higher interest rates, in that those higher interest earnings are exempt from taxation.

When the Glass-Steagall Act was passed, very few revenue bonds were utilized by State and local governments and it was not considered restrictive to grant commercial banks the authority to underwrite only general obligation securities. With the passage of time, we can now examine the experience of general obligations markets, where nonbank underwriters and commercial banks compete every day for the underwriting of municipal issues. There is very substantial evidence, we believe, in the general obligation market that competition works.

The claims by opponents of this legislation that banks and dealers cannot coexist in the municipal market have not occurred in real life. As you know, since the passage of the Glass-Steagall Act, State and local governments have come to rely more heavily on revenue securities. It is interesting that these securities are considered safe investments and that banks, as investors, may buy them but are yet unable to underwrite the same bonds.

This anomaly already creates serious difficulties for us, and these difficulties will increase as State and local governments increase their bond financing through revenue bonds.

The resistance on the part of the voters to tax increases and the passage of proposition 13-type spending limitations has resulted in an increased reliance on user charges and revenue bonds. In financing revenue bonds, by charging user fees, what we are really talking about is taking taxpayer dollars from one pocket instead of the other. In the final analysis, taxpayers still are footing the bill.

I want to make plain, as we did in our original adoption of this position, that our analysis and resolution in favor of commercial bank underwriting of revenue bonds can——

The CHAIRMAN. I have to ask you to do the same thing. I apologize to all three of you for your patience, waiting all morning, taking so long to get your testimony and then being cut off so short. But we will include all of your testimony in the record.

This completes the first 4 days of our hearings. We will continue next Tuesday with additional hearings on this legislation.

[Complete statement of Mr. Reynolds follows:]

TESTIMONY OF WILLIAM J. REYNOLDS, PRESIDENT, MUNICIPAL FINANCE OFFICERS ASSOCIATION, AND COMPTROLLER, GREENWICH, CONN.

Mr. Chairman and Members of the Committee, I am William J. Reynolds, president of the Municipal Finance Officers Association and Comptroller of the Town of Greenwich, Connecticut. The Municipal Finance Officers Association represents 9,000 members who are State and local government finance officers, appointed or elected officials, and public finance specialists.¹ I appreciate the opportunity to appear before the Banking Committee to comment on two pieces of legislation which we believe are in the best interest of State and local governments. The first bill which you have introduced, Senator Garn, S. 1427, would permit commercial banks to underwrite revenue bonds. The second piece of legislation, S. 1686, has been introduced by Senator Lugar from Indiana, and it would provide two opportunities for the efficient investment of State and local government cash balances.

Like our counterparts in the private sector, State and local government financial managers are always seeking the most efficient management of our resources. While these two banking bills are in two separate, and oftentimes unrelated, areas

¹The Municipal Finance Officers Association is headquartered in Chicago, Ill., at 180 North Michigan Avenue, and also maintains a Washington, D.C., office at Suite 650, 1750 K Street NW., 202/466-2014.

of governmental finance, the basic philosophy behind each of the bills is the same. State and local government officials have a responsibility to seek the most efficient management of our governments and, in so doing, we need to secure the highest possible level of competition for services and resources.

MFOA POLICY POSITIONS ON S. 1427 AND S. 1686

Since 1973, the Municipal Finance Officers Association has supported legislation which we believe would assist us in reducing the interest costs on our revenue bonds financing by providing additional competition for the marketing of these bonds.

At our recent 1981 annual conference, our association adopted a policy statement in support of federal legislation (S. 1686) which would provide state and local governments with additional opportunities to invest cash balances at higher interest rates.

COMMERCIAL BANK UNDERWRITING

The MFOA's position on the question of commercial bank underwriting of revenue bonds is not a new one. In 1973, the MFOA Committee on Governmental Debt Administration gave this question close and independent consideration. The fruits of that study were embodied in an issue paper and a proposed resolution that were sent to our membership for their comment. Subsequently, the resolution was ratified by the association's executive board in November of 1973. We have remained in touch with the issue over the years and have reexamined our position from time-to-time.

The two original reasons for our support of bank underwriting of state and local revenue bonds continue to hold. First, revenue bonds are a large and growing part of the debt instruments offered by state and local governments. Back in 1973, when we first considered the question, revenue bonds comprised about 40 percent of all municipal bonds sold (or about \$10 billion in annual volume). Today, revenue bonds represent, on average, about 70 percent of all bonds sold (or approximately \$34 billion a year). (See attached chart.) Obviously, any action that might enhance the market for these securities and lower the cost of borrowing, without adverse side effects, is worthy of our support and implementation. To fail to seek improvements in the market for our obligations, especially when such a large and growing part of it is involved, would be irresponsible.

Second, it continues to be our belief that permitting banks to underwrite and deal in revenue bonds would promote competition for those securities and lower borrowing costs for issuers. As you know, a large number of studies have been conducted on this subject. It is our opinion that the weight of evidence continues to indicate that bank entry should add to the number of bids received on issues and, thereby, lower the cost of borrowing. We believe that our original estimates (October 16, 1973) of a reduction in reoffering yield of approximately five to ten basis points continue to be in a range that could be reasonably expected. We further believe that underwriter's profits might be somewhat reduced. Academics and others will continue to argue about how much would, in fact, be saved and the comparative virtues of different methods of estimating those savings. A recent compilation of estimates shows the range of savings in total borrowing costs (in present value terms) to be in the range of \$80 to \$310 million at 1977 borrowing levels, assuming no reduction in the dollar volume of borrowing done by negotiation.² In the absence of convincing arguments as to why increasing competition for our securities would be detrimental to state and local governments, we feel compelled to abide by both the evidence and the simple economic logic that added competition would enliven and perfect the market for our securities. The burden we believe is to show why expanded entry to the municipal market would in some way be damaging to state and local governments in terms of their access to the market and borrowing costs. We have not been convinced by the arguments to date that MFOA should support continued restrictions against bidding for bonds by all qualified potential buyers.

As Government officials, we all serve the same master, our common constituent, the taxpayer. It is our mutual responsibility to provide needed government services in an effective and efficient manner. In the past five or six years, while this very legislation has been before Congress, inflation has eaten up 90 percent of all revenue increases for state and local government. The voters are telling us, through the passage of proposition 13S and other spending limitation measures, to improve the efficiency of government and to provide services at the lowest possible cost. The Federal Government should not impede our efforts to improve the efficiency of

²William L. Silber, "Municipal Revenue Bond Costs and Bank Underwriting: A Survey of Evidence" (Sept. 28, 1979), Table 4.

government by retaining roadblocks which exacerbate the fiscal pressures upon state and local budgets.

Mr. Chairman, the main issue before us today is competition. I believe that a competitive, free market system is one of the basic principles of our economy. MFOA believes that there will be significant savings through the introduction of bank competition in the revenue bond underwriting market. The current prohibition on commercial bank underwriting imposes hidden costs on State and municipal revenue bond issuers and, ultimately, on the taxpayers.

At the time the Glass-Steagall Act was passed, very few revenue bonds were utilized by State and local Governments. Consequently, it was not considered restrictive to grant commercial banks the authority to underwrite only our general obligation securities. We are very fortunate, indeed, that we can examine the experience of the general obligation market where non-bank underwriters and commercial banks compete every day for the underwriting of municipal issues. There is substantial evidence, we believe, in the general obligation market—that competition works. The claims by opponents of this legislation that banks and dealers cannot coexist in the municipal market have not occurred in real life. As you know, since the passage of the Glass-Steagall Act, State and local governments have come to rely heavily on revenue securities. It is interesting that these securities are considered safe investments, and that banks, as investors, may buy them, but yet unable to underwrite these very same bonds. This anomaly already creates serious difficulties for us and these difficulties will increase as State and local governments increase their bond financing through revenue bonds.

The resistance on the part of the voters to tax increases and the passage of proposition 13-type spending limitations has resulted in increased reliance on user charges and revenue bonds. In financing revenue bonds by charging user fees, what we are really talking about is taking taxpayer dollars from one pocket instead of another. In the final analysis, the taxpayer is still footing the bill.

Members of the committee who are concerned that commercial bank underwriting will drive out non-bank underwriting of revenue bonds should carefully examine the experience in the general obligation market. As an experienced municipal finance officer, I can assure you that the competitiveness which has occurred in the general obligation market will be very similar to what one would see if there was open competition in the revenue bond market. Commercial banks have freely participated in the general obligation market and they have not dominated the underwriting of these bonds, even when general obligation bonds were the primary form of tax-exempt bonds. Given this experience, it is very difficult for me to understand how the banks, which do not dominate the general obligation market today (where they compete with nonbanks), will be able to dominate the revenue bond underwriting market. The general trend for all municipal bond underwriting has been in the direction of more competition and less concentration by the largest underwriters, both bank and nonbank. The question is: Do we want more competition or do we want to continue anticompetitive practices? The answers which are being provided here today by Government officials from large and small communities is that commercial bank underwriting of revenue bonds is likely to lead to more competition and cost savings to all our Governments.

As responsible public officials, it is our mutual responsibility to see that adequate safeguards are contained in any legislation which will permit commercial bank underwriting of revenue bonds. The provisions in S. 1427 which provide these safeguards and the supervision of this market by the municipal securities rulemaking board should prevent conflicts of interest. Not only are the banks under the supervision of State and Federal bank regulators, they are also subject to the rules of the municipal securities rulemaking board, which are enforced by both the bank regulatory agencies and the Securities and Exchange Commission. The disclosure which is required by the MSRB and the *disclosure guidelines for State and local Governments*, which have already been developed by the Municipal Finance Officers Association, will clearly protect State and local Governments and investors.

I want to make plain, as we did in our original adoption of this position, that our analysis and resolution in favor of commercial bank underwriting of revenue bonds pertains to the immediate and particular question of lowering the cost of capital for governmental borrowers. We have not considered nor do we think it is our province or capability to consider long-range, broader questions of competition and balance among the institutions in the nation's capital markets. This committee should turn to the well-respected opinions of the comptroller of the currency and the Federal Reserve board in this regard.

S. 1427 addresses a narrow issue. If revenue bonds had existed in 1933 as they do today, I am confident that we would not be here today. As previous witnesses have said, all we are asking Congress to do is cure a legislative anomaly to close the

circle of bank competition in the field of public securities. I do not deny that the gap in the circle is substantial and constantly increasing in size. Most observers of the tax-exempt market would agree that it is impossible to estimate precise market effects; but as municipal finance officers, we do know that ranges of estimates can be good indicators of what will happen to the tax-exempt bond market in the future. While assumptions in interpretations in the studies can be biased toward various viewpoints, the results point in the direction of savings which we feel is significant.

Congress has visited this issue of bank underwritings of public securities in various contexts some 15 times since Glass-Steagall was passed. It has amended the section which S. 1427 would amend to provide bank competition for issuers such as the Asian Development Bank, the World Bank, the Washington Metropolitan Transit Authority, and the TVA, to mention just a few.

We feel that S. 1427 merely repeats the congressional policy clearly stated in 1933 and the trend which has been stated 15 times since: that commercial bank competition is appropriate and essential to the efficient underwriting and dealing in public securities. S. 1427 in no way changes the underlying philosophy of Glass-Steagall.

It continues to be our hope that whatever decisions are made, that State and local governments must not forego opportunities to borrow as efficiently as possible and to maximize their market and the number of competitors that can freely compete for their securities. We urge you to give this matter your serious attention and to act favorably upon S. 1427. Anticompetitive practices and the concomitant increase in costs to State and local governments are very unfair to our common constituents, the taxpayers.

OPPORTUNITIES FOR IMPROVED CASH MANAGEMENT

Mr. Chairman, efficient management of cash resources is especially important to State and local governments during this period of economic stress. State and local governments have suffered a series of economic setbacks as a result of Federal budget cutbacks and high municipal borrowing costs.

Creative financial management techniques are important to both State and local governments and profit-making private sector corporations. S. 1686, introduced by Senator Lugar of Indiana, proposes two measures which would provide opportunities for improved State and local government cash management. The first item would permit short-term deposits of all state and local government funds in financial institution accounts to earn interest slightly below the average federal funds rate. The second measure would allow State and local governments to maintain negotiable order of withdrawal (NOW) accounts.

This ability to earn higher interest rates on potentially significant amounts of public funds would allow State and local governments to earn greater returns on cash investments.

These two measures would provide additional cash management tools to foster effective use of cash balances. Just as in the private sector, a corporation strives to maximize the holdings of the stockholders; the public sector has the same responsibility to its stockholders—the taxpayers.

Although MFOA views this legislation as a mild remedy for soothing the pain of stringent fiscal conditions, it would create additional avenues that State and local governments could follow in effective investment of our cash.

INVESTMENT OF SURPLUS STATE AND LOCAL GOVERNMENT FUNDS

Mr. Chairman, S. 1686 would allow State and local governments to deposit surplus funds in financial institutions at an interest rate slightly below the average federal funds rate. Enabling legislation passed by the 95th Congress extended to the Federal government the ability to deposit treasury tax and loan account funds in depository institutions on demand at interest rates slightly below the average Federal funds rate. This legislation would extend the same ability to state and local governments to earn at these higher rates currently enjoyed by the Federal Government sector.

This bill would enable state and local governments to improve existing cash management practices because there will be additional opportunity for the efficient management of our cash assets. While some state and local governments currently invest surplus funds in repurchase agreements and in short-term treasury bills, these markets are not always available, especially to smaller units of government. Some units of government with relatively small amounts of funds to invest do not enter these markets because of the lack of staff in smaller jurisdictions or the lack of required minimum balances. S. 1686 would allow state and local governments to deposit surplus funds in financial institutions and earn interest at rates slightly below the federal funds rate.

In a survey compiled by MFOA earlier this year, states and localities reported that \$46.7 billion³ was held in time deposits. The average rate of interest for this type of investment in April 1981 was 11.72 percent,⁴ however; the federal funds rate for the same period was 15.72 percent.⁵ If state and local government deposits were earning an interest rate of one-quarter of one percent below the average federal funds rate, or 14.47 percent, the increase in interest income would have been approximately \$1.3 billion, computed at an annual rate of interest. Although this example is simplified, it does demonstrate the potentially higher investment earnings that would be available to the state and local sector if this legislation is enacted.

MFOA feels that state and local governments should be able to take advantage of opportunities to earn the greatest return possible on their investments, particularly in light of inflation, taxpayer resistance to increasing taxes, increasing demands for services and the decline in federal grant funds. Providing for the higher interest earnings on state and local government accounts is a further step toward removing the governmentally imposed restriction on the payment of interest on various types of accounts at financial institutions.

MFOA supports, and has policy that encourages, changes in federal statutes to allow state and local government units to enjoy the same access to depository institutions as the federal government and invest surplus funds at the highest rates possible. This policy, a copy of which is attached, was adopted at our annual meeting in June of this year. We hope you will give serious consideration to including a similar provision in this bank reform bill.

STATE AND LOCAL GOVERNMENT DEPOSITS IN NEGOTIABLE ORDER WITHDRAWAL ACCOUNTS

S. 1686 would allow all general-purpose units of state and local governments to hold interest-bearing negotiable order of withdrawal (NOW) accounts.

The Depository Institutions Deregulation and Monetary Control Act of 1980 authorized depository institutions nationwide to offer NOW accounts beginning on December 31, 1980. At that time, banks in Massachusetts and New Hampshire had been offering interest-bearing demand accounts since 1973, and banks in Connecticut, Rhode Island, Maine, and Vermont since 1976.⁶

In implementing the 1980 statute, the Federal Reserve Board and the Federal Home Loan Bank Board (FHLBB) temporarily utilized the New England regulations governing NOW accounts and restricted participation to deposits or accounts which consist solely of funds in which the entire beneficial interest is held by one of more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, education, or other similar purposes and which is not operated for profit. The regulations denied general-purpose units of government access to NOW accounts.

Presently, only special-purpose governmental units can maintain now accounts in banks if the funds are in the name of or used by schools, colleges, universities, libraries, hospitals, or other medical facilities.

In August of this year, the federal home loan bank board (FHLBB) proposed a ruling that would have allowed savings and loans to offer now accounts to general-purpose state and local government units. However, the American Bankers Association vigorously opposed the ruling on the claim it would have been an unfair competitive advantage for thrift institutions. The Bankers' Trade Association challenged the ruling in court and won a permanent injunction prohibiting state and local government participation in now accounts. Hopefully, the ABA will find S. 1686 acceptable, since all financial institutions will have equal access to the deposits of state and local government surplus funds.

Based on our estimates, demand deposits held by state and local governments in commercial banks at the end of 1980 totaled approximately \$11.3 billion.⁷ If all of these funds had been held in now accounts at an interest rate of 5.25 percent, they

³ John E. Petersen, "Estimating the Impact of IRS Revenue Procedure 80-55 on State-Local Short-Term Investment and Borrowing" (February 1981) p. 4.

⁴ Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, July 1981 (Washington, D.C.) p. A71.

⁵ Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, July 1981 (Washington, D.C.) p. A25.

⁶ Geoffrey Woglom, Federal Reserve Bank of Boston, "Special Report/The NOW Account Experience in 1976," (Boston, MA) p. 1.

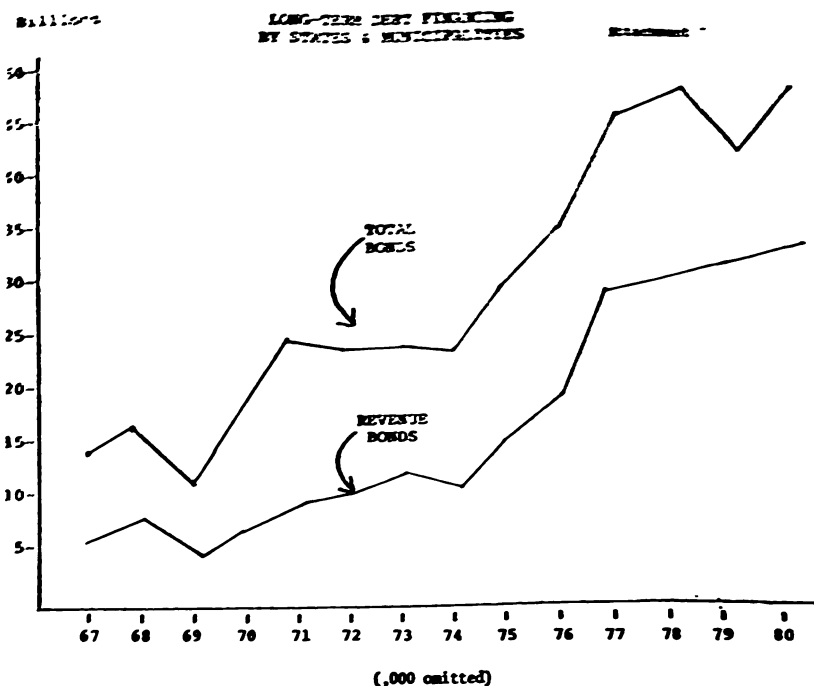
⁷ Board of Governors of the Federal Reserve System, "Flow of Accounts 1949-1978" (Washington, D.C., December 1979), p. 133; and

Board of Governors of the Federal Reserve System, "Flow of Accounts, First Quarter 1981 Seasonally Adjusted and Unadjusted" (Washington, D.C., May 1981), p. 13.

would have earned \$593.2 million, without allowing for compounding. As you can see, this is a substantial sum for state and local governments.

We are not implying that all state and local government demand deposits will or should be deposited in now accounts. Now accounts will, in all likelihood, be considered as one of the investment tools available to financial managers who seek to invest surplus funds in interest bearing accounts. Now accounts might prove to be especially useful to smaller local governmental units. In states such as your own state of Utah, where a majority of municipalities have populations of 50,000 or less, this cash management technique might prove to be especially productive.

Mr. Chairman, I appreciate the opportunity to present the views of the municipal finance officers association on both of these bills. Should you have any questions, we would be pleased to answer them.



Year	Total Bonds	Revenue Bonds	Revenue as a % of Total Bonds
1967	14,405,352	5,460,746	37.9%
1968	16,319,507	7,044,178	43.2%
1969	11,702,028	3,966,354	33.9%
1970	18,082,509	6,230,738	34.5%
1971	24,929,063	9,710,571	39.0%
1972	23,692,402	10,565,384	43.7%
1973	23,821,477	11,651,678	49.0%
1974	23,584,809	10,458,468	44.3%
1975	30,659,442	14,685,087	47.9%
1976	35,415,683	17,215,585	48.6%
1977	46,705,886	28,587,547	61.2%
1978	48,189,731	30,400,140	63.1%
1979	43,317,000	31,256,000	71.2%
1980	48,462,000	34,267,000	70.7%

Sources: The 1978 PSA Statistical Yearbook (p., H-1) and;
Federal Reserve Bulletin, July 1981 (p.A34)

MUNICIPAL FINANCE OFFICERS ASSOCIATION

Policy Statement

INTEREST EARNINGS OF STATE AND LOCAL GOVERNMENT DEPOSITS

The Municipal Finance Officers Association is aware of the ability of the federal government to deposit Treasury tax and loan account funds in depository institutions on demand at interest rates slightly below the average Federal Funds rate. This ability to earn higher interest rates on potentially significant amounts of public funds is not currently available to accounts of state and local governments. MFOA feels that state and local governments should be able to take advantage of opportunities to earn the greatest return possible on their investments, particularly in light of inflation, taxpayer resistance to increasing taxes, increasing demands for services and the prospective decline in federal grant funds. Providing for the payment on state and local government tax and loan accounts is a further step toward removing the governmentally imposed restrictions on the payment of interest on various types of accounts at financial institutions.

The Municipal Finance Officers Association hereby supports changing federal statutes to allow state and local governments to enjoy the same access to financial institutions as the federal government to the earning potential of surplus funds.

Adopted: June 17, 1981

The CHAIRMAN. There is one thing the clock is sparing you. The first question was going to be to have you each analyze the professor's analysis of the cost. [Laughter.]

The clock has spared you from doing that.

Thank you for coming today. The committee is adjourned.

[Whereupon, at 12:52 p.m. the hearing was adjourned.]

[Additional material received for the record follows:]

The Mortgage Corporation

Philip R. Brinkerhoff
President
Chief Executive Officer
(202) 789-4720

Federal Home Loan Mortgage Corporation
1776 G Street NW, P.O. Box 37248
Washington, D.C. 20013 (202) 789-4700

October 22, 1981

The Honorable Jake Garn
Chairman
Committee on Banking, Finance
& Urban Affairs
5207 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Garn:

I wish to express my appreciation to you for including a provision in your bill, S. 1720, which would remove a section in the Federal Home Loan Mortgage Corporation's Charter Act which limits the volume of loans which may be more than one year old when sold to the Federal Home Loan Mortgage Corporation (the Mortgage Corporation) to 20 percent of the total volume. I urge your support for passage of this provision before the end of this year. There is an urgent need for Congress to enact this legislation in order to continue a highly successful program which the Mortgage Corporation began recently to permit the swapping of older, low-yielding mortgage loans for Mortgage Corporation Participation Certificates (PCs). This program, which converts illiquid mortgages into highly liquid securities, has been enormously popular with mortgage lenders. It will, however, be terminated before the end of the year unless the 20 percent ceiling is removed.

BACKGROUND

The Mortgage Corporation's original Charter Act, passed in 1970, specified that no more than 10 percent of the loans the corporation purchases over time could be more than one year old when sold to the corporation. At the time, housing starts had dropped to low levels and very little mortgage lending was taking place. Congress limited the corporation's purchases of older loans so that the new corporation's very limited programs would be used to finance new mortgage originations. This figure was later increased to 20 percent in the Housing and Community Development Act of 1974.

During the past ten years, lenders have sold the corporation newly originated loans. As interest rates have risen, lenders have been able to sell older and, therefore, generally lower-yielding loans to the corporation only at a discount, which is necessary in order to give the corporation its required yield. Lenders, who sell at a discount to raise the yield to the investor, are required to book a loss and have generally been unwilling to incur these losses. Thus, throughout the last ten years, the corporation's personnel and processing resources were fully utilized in purchasing newly originated loans.

This year, however, the corporation's financing costs are well above the yields lenders can offer, and purchase volume has been depressed. As a result, the corporation has a significant amount of excess processing capability.

At the same time, financial institutions are experiencing severe earnings and liquidity problems, in part because they have sizable portfolios of loans which are below current market rates. These below-market portfolios have troubled the industry and Congress for several years.

GUARANTOR PHASE I - THE "SWAP" PROGRAM

The corporation has developed the Guarantor Phase I or the "SWAP" program which will enable financial institutions to sell portions of their low-yielding loan portfolios, and in exchange, receive PCs. The financial institutions sell a pool of mortgage loans of at least \$10 million to the corporation and receive in return a PC which represents an interest in those same mortgages. The PC's bear a slightly lower rate than the rate on the mortgages, with the spread representing the corporation's processing costs, its guarantee and profit. The PCs are a more liquid instrument which can be used for a number of purposes. PCs used as collateral for borrowings in the general capital markets can substantially reduce institutions' borrowing costs.

During this past summer, the corporation committed about \$1.75 billion in SWAPs on an experimental basis to determine the benefits of this program to both the housing finance field and to the corporation's profitability. Following the successful experimental phase, the corporation moved into the "Pilot" program phase in early September. This phase is the forerunner of the Guarantor Program which we hope to begin next year following passage of the corporation's recapitalization legislation. The pilot phase will enable the corporation to test some of the major procedures which will be used for that program and to develop enhancements which will make the program more beneficial to all lenders. At our first auction held on October 5, the enthusiastic response of lenders to this program was reflected in the level of offers. Over \$2.4 billion worth of mortgage loans were offered to us. We accepted \$1.8 billion of these offers.

Based upon the highly favorable response we have received from lending institutions, we anticipate that the demand for our pilot program will be at least \$3 billion for the remaining two months of the year. If we accepted all the loans offered to us, our total volume of SWAPs could exceed the maximum amount we can purchase under the 20 percent ceiling in our Charter Act. We currently estimate that we can purchase only \$4.4 billion in loans which are older than one year for calendar year 1981 unless this obstacle is removed. This means that we can commit to purchase an additional \$1.5 billion worth of loans older than one year before we exceed the ceiling. It is likely that, based

upon lenders' interest in this program, we will reach our 20 percent ceiling limit at the November auction and the program will be shut down. The program would remain closed until purchases in the corporation's other programs reach a volume, 20 percent of which is sufficient to make it feasible to hold another SWAP auction. Based upon projected demand for our other programs next year, the volume of new loans offered will likely be depressed for most of 1982. As a result, it is unlikely that the SWAP program could be offered at a high level during most of 1982 without passage of the legislation we are seeking.

The SWAP program provides lenders a number of advantages in dealing with a portfolio of low yielding mortgages. In a SWAP transaction, the lender receives PCs in exchange for low coupon mortgages. The lender is not required to show a regulatory or financial accounting loss (except for the spread between the yield to the corporation and the PC certificate rate) as long as the PCs are held in portfolio. The PCs which the lender obtains in exchange for the mortgages are instruments which may be used as collateral for loans to meet both short-term and long-term needs of the institution. The use of PCs as collateral can save institutions two to three percent over the cost of unsecured borrowings. For example, PCs may be used as collateral for borrowings at the Federal Reserve Board discount window recently opened to saving and loan associations. Mortgages would be far less attractive for this purpose. Further, the lender may enter into reverse repurchase agreements with the PCs as a means of borrowing funds, for example, to meet deposit withdrawals or interest payments to depositors. The use of PCs as collateral for retail reverse repurchase agreements has recently been authorized by the Bank Board. These agreements are used by lenders in competing with money market funds.

One anticipated use of the SWAP program is the formation of PCs backed by mortgage loans which are only a few percentage points below market. If market rates fall to a level where the PC is more competitive, the lender can immediately offer the PCs in the capital markets and gain new lending funds. This would be less expensive and time consuming than selling loans through the corporation's purchase programs in which the lender competes for commitments with other lenders across the country for access to the corporation's finite processing capacity.

Recently issued Federal Home Loan Bank Board regulations make the SWAP program even more attractive to lenders. These regulations provide that any loss resulting from the sale of mortgages, including the PCs which have been swapped for mortgages, may be recognized over the estimated remaining life of the loan rather than in the year of sale. This change will make it more feasible for some lenders to buy PCs in the SWAP program, and immediately sell them at a discount to increase their liquidity, because they will be able to spread the loss over a period of years.

Other advantages of the SWAP program are that it uses the corporation's existing excess processing capability to assist troubled financial institutions without expending government funds, without causing a "crowding effect" in the capital markets, and without diminishing the corporation's regular purchases of newly originated loans. In fact, profits generated by the SWAP program support purchase programs for new mortgage loans. While the program does not solve the problem of the low-yielding portfolio, it does help lower lenders' costs of borrowing in order to meet their liquidity needs. The corporation will cover its costs for this program through the spread between the PCs and underlying mortgages. During the pilot phase, lenders will bid a spread in excess of 25 basis points, regardless of the underlying mortgage rates. For example, a lender will bid a yield of at least 8.25 percent on mortgages to be sold in return for a PC bearing a rate of 8.00 percent. To receive a PC with a yield of 10.00 percent, the lender will bid at least 10.25 percent.

RESPONSE TO QUESTIONS RAISED BY THE MORTGAGE BANKERS ASSOCIATION

Questions have been raised by the Mortgage Bankers Association as to whether packaging seasoned mortgages is an appropriate role for the corporation and whether this program may divert our resources away from providing funds for new mortgages. The corporation does not view these functions as mutually exclusive. We consider our activities in the new and seasoned loan areas as complementary.

Over most of the last ten years, the greatest need in the mortgage lending industry has been sales of new loans. Our programs have been available to purchase over \$25 billion worth of new loans. Although our charter requires no more than 20 percent of our portfolio be in loans over one year old, the corporation has imposed no restrictions on the sale of all loans in our programs. We have merely monitored the percentage of old loans flowing to us. Under this free market approach, less than 4 percent of the loans we purchased prior to the SWAP program were older than one year. Our full expectation is that the volume of old loans will diminish when interest rates fall to affordable levels for new mortgage originations. In the meantime, we can use our current excess capacity under the SWAP program to aid institutions burdened with old low yielding loans while providing profitable activity for the corporation. These profits will in turn help us to further support the new mortgage origination market as it recovers. We will be able to lower our yield requirements more rapidly than if we had to make up our losses from this new volume.

Questions have also been raised as to whether the SWAP program will drain our current capital base. As you know, we are in the process of actively addressing the future need for additional capital for the

corporation through our proposed recapitalization legislation that has been submitted to this committee. All of the major trade associations that represent the institutions which do business with the corporation have endorsed this legislation which we hope will move through your Committee early next year. The corporation will not permit the SWAP program to stretch its capital beyond a prudent relationship to our contingent liabilities. Clearly, the corporation would prefer to expand its capital base rather than restrict our assistance to housing. We, therefore, request your support for our restructuring legislation in order to ensure that we have sufficient capital in the future for both the purchase of newly originated mortgage loans and SWAPs of older loans.

It has been recommended that the SWAP program accommodate both old and new mortgages equally and that the minimum acceptable bid be lowered from \$10 million. I want to emphasize that this program is currently in its "pilot phase." We plan to expand the program in the future to do such things as reduce the minimum bid. Our first auction has concentrated on pools of loans which are considerably below market. We certainly see expansion of the program to loans which are closer to market rates in the future. The use of the guarantor program for new originations is embodied in our recapitalization bill.

RESPONSE TO PROPOSAL FOR TEMPORARY REMOVAL OF CEILING

A proposal has been submitted for consideration by the Committee, which would place a one-year limitation on the statutory provision removing the 20 percent limitation. At the end of the one-year period, the 20 percent limitation would automatically take effect and the older loans purchased during the preceding one year would not count toward the cumulative total.

The corporation opposes this proposal which would deny us needed flexibility in the operation of our programs. The 20 percent limit is an arbitrary ceiling which bears no relationship to market realities. The sound arguments which favor a one year lifting of the ceiling should apply even more to a permanent removal. The fundamental question seems to be whether it is an appropriate role for the corporation to respond to changing market needs by developing programs like the SWAP program, and whether the Congress wishes to restrict our ability to respond quickly to changing markets. The question in this case is not to determine the need for this type of program, which has already been proven, but to satisfy the concerns of non-portfolio mortgage lenders of our continued commitment to the purchase of new mortgages. I want to emphasize, that the SWAP program does not represent a fundamental shift in the corporation's operations. It is the corporation's goal to meet the needs of housing in all markets.

It is our hope that this highly successful program will not be discontinued based upon these unfounded fears. Because the program

meets the needs of portfolio lenders to a greater extent in some cases than non-portfolio lenders is a function of the market place which will, hopefully, reverse itself as lenders sell in greater volume in the secondary market. For those lenders whose business it has always been to sell the loans they originate, there is clearly less of a need for this program. This, however, is not a justifiable reason for limiting its availability to those lenders holding sizable portfolios of older low-yielding mortgage loans who have expressed a strong interest in this program.

FDIC AND NCUA PROVISIONS

The corporation has also requested an amendment to its Charter Act to give the FDIC and National Credit Union Administration the same seller/servicer status as the FSLIC. This amendment would give these two entities the flexibility to utilize the SWAP Program to aid troubled financial institutions and to dispose of loan portfolios acquired in takeovers.

I urge your support for passage of these provisions so the corporation can provide assistance to the industry during the remaining quarter of this year and in the future.

Thank you for your consideration of these issues.

Sincerely,



Philip R. Brinkerhoff

PRB/maw

1101

ASSOCIATION of BANK HOLDING COMPANIES

DONALD L. ROGERS
PRESIDENT

730 FIFTEENTH STREET, N.W., WASHINGTON, D.C. 20005
(202) 383-1158

October 15, 1981

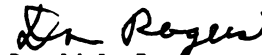
Honorable Jake Garn, Chairman
Senate Committee on Banking,
Housing and Urban Affairs
Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Congratulations on your leadership in sponsoring the bill, S. 1720, to help make banks and bank holding companies more viable competitors in the financial services market. We believe your bill is so important that all of the responsible elements of the banking community should be united in presenting their views to your Committee. For this reason, we support the testimony of the American Bankers Association on this legislation, and we will not present a separate statement.

We would appreciate your making this letter a part of the record of the hearing on S. 1720.

Sincerely yours,


Donald L. Rogers

DLR:slg

cc: Committee Members

THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

1922 F STREET, N. W.
WASHINGTON, D. C. 20006

MICHAEL L. KERLEY
CHIEF COUNSEL-GOVERNMENT
AFFAIRS

4 12021 33-6022

October 22, 1981

The Honorable Jake Garn, Chairman
Committee on Banking, Housing and
Urban Affairs
5300 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The National Association of Life Underwriters (NALU), a federation of state and local associations which collectively represent over 130,000 life and health insurance agents, is happy to associate itself with the remarks of Mr. Edward J. Kremer of The Independent Insurance Agents of America. Mr. Kremer spoke before the Committee today on S.1720. Mr. Kremer indicated in his oral remarks that as a matter of convenience to the Committee he was speaking on behalf of NALU, The National Association of Professional Insurance Agents, and The National Association of Casualty and Surety Agents, as well as the Independent Agents.

NALU supports the adoption of Title VI of S.1720. It is identical with S.207 which was the focal point of NALU testimony before the Committee May 6, 1981.* However, because of the other provisions in S.1720, we believe that Title VI should be expanded.

NALU's major concern centers around the insurance marketing powers of savings and loan association service corporations or savings and loans operating as part of holding companies. Savings and loan associations, as part of holding companies or through service corporations, have much broader insurance marketing powers than bank holding companies. S.1720 contemplates the transformation of federal savings and loan associations into entities resembling national banks. While NALU has no objections to this transformation, it does believe that the same insurance agency restrictions applying to commercial banks (either individually or through the holding company devise) should apply to savings and loan associations and/or their service corporations.

* See hearing "Competition and Conditions in the Financial System," Part I at page 451.

At the same time, other proposals contemplate the merger of savings and loan associations with commercial banks and bank holding companies. Once again, NALU does not object to the restructuring of financial institutions provided the resulting entities maintain an equitable competitive stance in relation to insurance agents.

If commercial banks are merged with savings and loan associations, it will not be long, of course, before requests surface to equalize the insurance agency powers of the merged S&L/Bank Holding Company. The pressure will be toward an expansion of the insurance agency activities of the merged entity rather than a cutting back.

Therefore, NALU will be supporting amendments to Title VI and possibility other titles of S.1720 so that the restrictions contemplated by Title VI will apply equally to savings and loan associations and/or a merged S&L/ commercial bank/bank holding company entity.

Enclosed is a copy of our statement to the Banking Committee last May. The statement examines the reasons why we think bank holding companies should be restricted in their insurance agency activities. We believe that the public, in the final analysis, will be better served if the general principle is observed that the businesses of banking and insurance don't mix. A complete severance of the business of banking from the business of insurance seems impossible at this juncture. However, it need not be permitted to grow any further.

We urge you, Mr. Chairman, to push for the enactment of Title VI of S.1720, as it may be amended to apply equally to reconstituted savings and loan associations or to merged commercial bank/bank holding company/savings and loan association entities.

Sincerely,



Michael L. Kerley
Chief Counsel-Government Affairs

Statement by

Dow Reichley, FMS
President

John S. Hoyt
Senior Vice President

of the National Association of

PROFESSIONAL INSURANCE AGENTS

The following position statement on S.1720, the "Financial Institutions Restructuring and Services Act of 1981," is submitted to the Senate Committee on Banking, Housing, and Urban Affairs by the National Association of Professional Insurance Agents (PIA).

PIA is a national trade association representing more than 38,000 independent property and casualty insurance agents in all 50 States, the District of Columbia, Puerto Rico, the Virgin Islands and Canada.

PIA's membership has long been concerned about the continuing efforts of bank holding companies (BHC) to get further involved in the business of insurance. We have carefully monitored this issue over the last decade and have voiced our opposition to BHCs selling insurance to House and Senate Banking Committees whenever an appropriate opportunity presented itself. PIA is also an active participant in the coalition of insurance producer trade associations that was represented before the Committee today by Edward J. Kremer, an insurance agent from Salisbury, Maryland.

Early this year, we were especially pleased when the Committee's distinguished chairman, Senator Jake Garn (R-Utah), co-sponsored S.207, a bill to amend the Bank Holding Company Act of 1956 to limit the property and casualty and life insurance activities of bank holding companies and their subsidiaries. PIA submitted a statement of support for S.207, when the Committee held banking oversight hearings on May 6th, that again raised the fundamental issue of BHCs being in a position to exert undue economic coercion upon borrowing consumers by making the purchase of insurance from the BHC an explicit or implied

condition of obtaining a loan.

S.1720 and related bills under consideration by the Committee have been introduced as vehicles for discussion about how to achieve workable legislative solutions to the financial problems facing regulated thrift institutions in the United States. According to the news media, there appears to be a real possibility that a number of savings and loan associations (S&L), mutual savings banks and even a few small banks may fail in the near future if nothing is done to relieve the difficulties they are experiencing caused by high and volatile interest rates. The adverse situation being forced upon the thrifts is further aggravated and complicated by the super competitive unregulated financial products and services being offered by a new type of player on the now not-so-level playing field. Insurance companies are taking over investment firms. A retail merchandise company, already controlling an S&L and an insurance company has acquired a large national real estate firm. A steel company buys a depository institution. These are but a few examples. The financial services industry and that market place are indeed experiencing far-reaching and fundamental change. The playing field is changing and this process will continue.

S.1720 attempts to deal with the above mentioned problems by granting thrift institutions the same general scope of operations as commercial banks and by authorizing interstate and cross industry mergers among federally regulated and insured financial institutions. Viewed in this context, it was encouraging to find S.207 included as Title VI of S.1720. Since our May 6th statement contained a detailed analysis of the BHC

issues here involved, there is no need to reiterate. Any effort by the Committee to curtail the insurance activities of BHCs and clearly define the permissible scope of such activity for the Federal Reserve Board is definitely a first step in the right direction.

Nonetheless, Title VI, as part of this comprehensive measure, would fall short of fulfilling its legislative purpose because it would, as a practical matter, be undercut by other provisions of S.1720. This is because banks and bank holding companies, and savings and loans, savings and loan holding companies (S&LHC) and their service corporations have differing legal authority to engage in insurance activities. Banks cannot generally function in the business of insurance, and BHCs are limited by Sec. 4(c)(8) of the Bank Holding Company Act from engaging in insurance activities unless the Federal Reserve Board finds that the insurance activity is "so closely related to banking" as to be a "proper incident thereto."

In contrast, S&Ls are prohibited from engaging directly in insurance activities but the service corporations that they own can freely sell insurance. One S&LHC can engage in all aspects of the business of insurance. Multiple S&LHCs can function as agents for all types of insurance.

Since S.1720, as introduced, expands the power of federal S&Ls to function as commercial banks and also allows BHCs to acquire failing S&Ls, some of which may be in States that allow S&Ls to branch, this effectively eviscerates Title VI. If past

efforts of BHCs to expand their insurance activities are any indication, the ability to acquire an S&L would provide BHCs with a golden opportunity to get generally into the insurance business. They would surely take advantage of this situation.

The remedy to this predicament must therefore limit the insurance authority of S&Ls and S&LHCs to that of BHCs, per the scope of Title VI. As this bill moves through the legislative process, appropriate amendments to maintain the so-called level playing field in terms of the insurance activities of regulated financial institutions will be offered to the Committee.

The separation of banking and general commerce has been a long-standing and wise public policy of the United States. We trust that this sound demarkation will not be allowed to lapse in efforts to solve the short-term solvency problems of the thrifts.

Indeed the real solution to the crisis of the thrift institutions is a successful national effort to control inflation. This can best be accomplished by further reductions in federal spending and less deficit spending by the Congress.

Mr. Chairman, we thank you for providing PIA this opportunity to express the views of our membership.

* * *

The State of South Carolina

Department of Consumer Affairs

2221 DEVINE STREET
P.O. BOX 5757
COLUMBIA, S.C. 29250-5757

October 23, 1981

6-127 12-27-81

The Honorable Jake Garn, Chairman
U. S. Senate Committee on Banking,
Housing, & Urban Affairs
Room 5300 Dirksen Senate Office Building
Washington, D. C. 20510

COMMISSIONERS
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BOBBY T. JONES
CAMDEN
VIRGINIA L. CROCKER
CLINTON
WILBUR LEE JEFFCOAT
SWANSEA
THOMAS L. MOORE
CLEARWATER

Re: S.1720

Dear Senator Garn:

I am writing to request that you include this letter in the record relating to S.1720. Although I will not be appearing as a witness, the Department of Consumer Affairs wishes to make you aware of its concerns with parts of that bill which would preempt State consumer credit laws including the South Carolina Consumer Protection Code, our State's Uniform Consumer Credit Code ("UCCC").

Title IV of S.1720 contains S.1406, the Credit Deregulation and Availability Act of 1981. I testified in opposition to S.1406 on behalf of the Department of Consumer Affairs and the American Conference of Uniform Consumer Credit Code States and enclose a copy of my earlier written testimony as a statement of our opposition to Title IV of S.1720. To summarize, we are opposed because it would upset the balance of the UCCC and therefore the Consumer Protection Code by preempting its provisions relating to rates and charges.

Title VII of S.1720 contains the miscellaneous provisions including those amending the Truth in Lending Act. We are especially concerned with § 704 captioned "Relation to State Laws." It would rewrite § 111 of the Truth in Lending Act by shifting from its current emphasis on preservation of States' rights in consumer credit regulation to abrogation of States' rights in consumer credit regulation. That section as amended would say that the Truth in Lending Act "supersedes any State law that is similar in purpose, scope, requirement, or content to this title, to the extent of the similarity. Similar laws include, but are not limited to, laws relating to the disclosure or advertising of consumer credit or lease terms, credit card and credit billing practices, liability for consumer lease transactions, and the rescission of consumer credit transactions." (Emphasis added)

Two of the purposes and policies of the South Carolina Consumer Protection Code contained in § 37-1-102(2)(c) and (f) (1976) directly concern disclosure of consumer credit terms:

To further consumer understanding of the terms of credit transactions and to foster competition among suppliers of consumer credit so that consumers may obtain credit at reasonable cost . . .

TELEPHONES (AREA CODE 803)

ADMINISTRATION
758-3017

CONSUMER COMPLAINTS
758-2040
WATS 1-800-922-1994

PUBLIC INFORMATION
758-7546

NOTIFICATION
758-8587

CONSUMER ADVOCACY
758-8996

To conform the regulation of consumer credit transactions to the policies of the Federal Consumer Credit Protection Act [which includes the Truth in Lending Act].

The Consumer Protection Code is a balanced State law setting forth rights and responsibilities of both consumers and creditors. Regulating consumer credit in its entirety, including disclosure, is a legitimate concern of South Carolina. Most consumer credit transactions, involving only personal, family or household purposes, are relatively small. Larger transactions involve acquisition of a home located in South Carolina. The Consumer Protection Code incorporates by reference the Federal Truth in Lending Act in §§ 37-2-301 and 37-3-301 (1976). Thus there is no inconsistency between the federal and South Carolina disclosure laws under our scheme of regulation. However, the Consumer Protection Code provides for dual enforcement of the Truth in Lending Act by requiring disclosure as a matter of State as well as federal law. Consumer Protection Code § 37-6-104(2) (1976) specifically requires the Administrator of Consumer Affairs to enforce the Truth in Lending Act "to the fullest extent provided by law." We can see no federal benefit resulting from removal of our State's right to enforce the Truth in Lending Act as a matter of South Carolina law while there would be detriment to South Carolina and its consumers if our enforcement power were taken away.

Truth in Lending Act § 108 provides for administrative enforcement of the Truth in Lending Act. Federally chartered creditors (such as national banks) are subject to regulation by a federal agency (such as the Comptroller of the Currency). The supervisory agency enforces the Truth in Lending Act for those creditors it supervises and regulates under other laws. All other creditors, which make up the vast majority, are subject to enforcement of the Truth in Lending Act by the Federal Trade Commission. The Federal Trade Commission does not have sufficient resources to adequately monitor compliance with the Act by all creditors subject to its jurisdiction. This is becoming more so with each succeeding federal budget cut. By removing South Carolina's power to enforce the Truth in Lending Act, Congress would in essence be removing any enforcement of Truth in Lending for most of our State's creditors.

Besides South Carolina's incorporation by reference of and enforcement responsibility for the Truth in Lending Act, many other sections of the Consumer Protection Code concern disclosure, advertising, credit cards, liability for consumer leases, and rescission, all of which would apparently be preempted if S.1720 were enacted in its current form. Part 3 of Chapters 2 and 3 of the Consumer Protection Code concern disclosure:

§§ 37-2-301 and 37-3-301 (1976) require compliance with the Federal Truth in Lending Act.
 §§ 37-2-302 and 37-3-302 require receipts, statements of accounts, and evidence of payment in some circumstances.
 §§ 37-2-303 and 37-3-303 require a plain language notice to co-signers other than the spouse concerning the nature of the obligation.

§§ 37-2-304 and 37-3-304 prohibit false, misleading, or deceptive advertising of rates, terms, or conditions of consumer credit.

Additionally, Part 5 of Chapter 2 gives the buyer in a home solicitation consumer credit sale the right to certain information as well as the right to cancel within three days. The latter is a form of rescission that is apparently preempted along with the disclosures. § 37-2-502. Other sections of the Consumer Protection Code apparently also preempted would include §§ 37-2-202(2)(b) and 37-3-202(2)(b) on consumer credit insurance, §§ 37-2-412 and 37-3-406 on notice of assignment, §§ 37-2-416 and 37-3-408 on change in terms of revolving charge accounts, § 37-2-406 restricting liability in consumer leases, § 37-3-411 on card issuer subject to claims and defenses, § 37-4-105 requiring notice in connection with insurance, § 37-5-203 on civil liability for failure to disclose, § 37-5-204 on rescission, and § 37-5-302 containing criminal penalties for willful and knowing failure to disclose.

Please consider the rights of the States to make and enforce their own credit laws before passing such a federal law. This is not the type of law one would expect to come from a Congress serving during a "States' rights" administration. While we are aware of no federal benefit resulting from preemption of State consumer credit laws, we do know that there would be detriment to South Carolina consumers in the loss of a law made by their own General Assembly to protect them, based on UCC provisions drafted by the National Conference of Commissioners on Uniform State Laws.

Next, we are concerned about the proposed change in definition of "creditor" in § 703 to delete arrangers of credit. Our experience shows that arrangers of credit prompt many consumer complaints. As "creative financing" increases, so will the number of arrangers in home acquisition transactions. Requiring certain arrangers to disclose credit terms to consumers should result in more understanding of terms in the single most important consumer credit transaction — purchase of a home. Deleting them from coverage would result in large numbers of home buyers receiving inadequate information about their purchases.

Also, we are concerned about the dilution of the civil liability provision in § 705 of S.1720. While we are not sure what "substantial noncompliance" would be, it is possible that nothing short of a total failure to comply would result in civil liability under the amended section. Diluting the federal provision while preempting the State provision leaves consumers without a remedy.

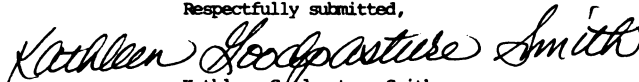
Finally, we are very concerned about the effective date and override provisions in S.1720. The law would go into effect prior to a State's having the opportunity to override it. Preemption necessarily results in chaos and confusion in a State raising unnecessary questions about which laws are valid and which are not in the interim between preemption and override. Also, while override is essential to any preemption law, we can see no reason for a

State's opportunity to override the federal legislation being limited to, for example, three years when the law is permanent. The effects of preemption may not be obvious for some time as South Carolina considers alternative courses of action in response to preemption. Why should a State be put in a "now or never" position?

In summary, we are opposed to Titles IV and VII of S.1720.

Regarding Part C of Title I of S.1720, although we have no statutes or court decisions directly concerning due on sale clauses, for the same reasons as above we believe our State should have the right to legislate or otherwise decide how this issue should be treated in South Carolina.

Respectfully submitted,



Kathleen Goodpasture Smith
Counsel to the Administrator

sbb
Enclosure

Addendum:

Enclosed at the request of William Morgan, Administrator of the Oklahoma Department of Consumer Credit, is a copy of a letter dated October 21, 1981 to Senator Boren.



Wm. S. Morgan
Administrator

Theima Roberts
Deputy Administrator

STATE OF OKLAHOMA

DEPARTMENT OF CONSUMER CREDIT

8-82 JIM THORPE BUILDING
OKLAHOMA CITY OKLAHOMA 73105
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COMMISSION
Anna Lee Westcott
Chairman
Ed Perry
Vice Chairman

Sue Heall
Jerry Goodwin
John P. Satter

R. Y. Empe
Bank Commissioner
Ex Officio

October 21st, 1981

The Honorable David Boren
United States Senator
440 Russell Senate Office Building
Washington, D. C. 20510

Dear Senator Boren:

Your guidance and advice will be appreciated regarding S.1720, "Financial Institutions Restructuring and Services Act of 1981," by Senator Garn. S.1720 is a savings and loan bail-out bill, however, other purposes are included.

The "other purposes" are preemption of state credit laws. Sections of the bill appear to negate efforts of Oklahoma in applying for exemption of the revised Regulation Z. S.1720 preempts "any state law that is similar in purpose, scope, requirement or content" to the Truth-In-Lending Act.

The Oklahoma Commission on Consumer Credit has instructed me to seek an exemption (Oklahoma has had such since 1969). S.1720 appears to make such effort an exercise in futility. Oklahoma exemption will expire on April 1, 1982, unless our application for exemption is approved by the Federal Reserve Board.

Other than frustration in approaching application for exemption, it appears S.1720 is a broad-scale attack against most of the consumer safeguards enacted by the Oklahoma Legislature, July 1, 1969, when the Uniform Consumer Credit Code was passed.

S. 1720 concerns savings and loan associations. The primary thrust of the bill is to assist such associations. The preemption provisions of the bill could be separated and considered apart from the savings and loan provisions. Signals from Washington are confusing. On one hand, return to the states' responsibilities for administration is stressed by the Regan Administration, on the other, preemption of states' authority to administer is appearing in more and more bills.

Thank you for your indulgence with this lengthy letter, however, S.1720 with other purposes is of concern to Oklahoma and the American Conference of Uniform Consumer Credit Code States (Colorado, Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah, Wisconsin and Wyoming). The Conference re-affirmed its opposition to S.1406, and incorporated in its entirety (title IV) in S.1720, and adopted a resolution in opposition thereto during the Annual Conference Meeting in Oklahoma City, September 29th, 1981.

Oklahoma seeks your advise and guidance in this matter as one of eleven Code States.

Cordially, •

William S. Morgan
Administrator

WSM:vld

**CALIFORNIA ASSOCIATION
OF
COUNTY TREASURERS AND TAX COLLECTORS**

October 26, 1981

Senator Jake Garn, Chairman
Senate Banking Committee
Washington, D.C. 20515

Re: S1720

Dear Senator Garn:

The following is written testimony to the hearings you are holding on S1720, particularly that portion regarding the Glass-Steagall Act. As President of the State Association of County Treasurers and Tax Collectors of California, I represent the views of 58 County Treasurers whose views were expressed on similar legislation (HR2828) at conventions of the Association in January 1981 and June 1981.

It has been proven that competition under our American free enterprise system is always healthy and essential. When any form of monopoly occurs the public/buyer suffers. The underwriting of Government Revenue Bonds is confined to the nonbanking security dealer organizations. Because of the merging of several security dealers, the number of bids received by government organizations for their revenue bonds has decreased. With the onslaught of increasing inflation the last few years, which has resulted in high interest rates to be repaid by the taxpayers through their government entities, the lack of competition amongst security dealers has been further heightened. The recent income tax cuts and reforms passed by the Congress has made it even further difficult to sell all types of Government tax free bonds, including Revenue Bonds. This is because the former large buyers of these types of bonds, such as the Casualty Insurance Companies and the national and State banks, do not need as much of this type of "tax shelter" that they needed in the past. Here in California the situation is even more acute with the passage of Proposition 13. The financing needs of public works projects in California is in serious jeopardy. We need the lowest interest cost possible particularly in Revenue Bonds (which are not voter approved), and we can only make certain that we receive the lowest possible interest rate through effective competition in the marketplace.

When the Glass-Steagall Act was initially passed, Revenue Bonds were unknown. The great majority of local government financing was through General Obligation Bonds. The Glass-Steagall Act gave national banks the prerogative of underwriting G. O. Bonds. We are certain that if Revenue Bonds were in existence at that time, that the Congress would have also given national banks the authority to underwrite Revenue Bonds. Revenue Bonds now account for 70% of all Municipal Bonds issued in the United States. Recently, both Los Angeles and Chicago issued Municipal Bonds in which each of them received

only one bid. The cause of part of this was due to the condition of the financial markets, but a major part of this was due to the monopoly that the security dealers have on underwriting of Revenue Bonds. So you can, therefore, understand why it is imperative that national banks be included for the underwriting of Revenue Bonds so as to restore competitiveness in the marketplace.

It has been stated that the inclusion of national banks to underwrite Revenue Bonds will bring savings to local governments (and for taxpayers) a sum of approximately \$400 million.

As you are aware, similar legislation has been introduced in the Congress in the last few years. There were two bills previously passed in the Senate and were killed by the House Banking Committee chaired by Congressman St. Germain. Currently there is HR2828 in which Congressman St. Germain refuses to hold hearings, even though there are 130 co-authors to this bill. Although S1720 includes many other provisions in the restructuring of the financial banking system of this country, we believe that the remaking of the Glass-Steagall Act is the cornerstone of S1720. It is our very strong testimony on this bill that it is imperative to assist in the survival of materially needed public works projects that the Congress authorize national banks to underwrite the issuance of Revenue Bonds.

Sincerely,



C. Ralph Howard, President
California Association of County
Treasurers and Tax Collectors

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